Overriding mandatory rules in Swiss international arbitration

the example of financial overriding mandatory rules

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Der Dekan: Prof. Dr. Thomas Gächter

For my parents Dimitrina and Tsanko

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List of abbreviations

Act – Swiss Private International Law Act, 18 December 1987, also referred to as PILA (abbreviation in English), IPRG (abbreviation in German) or LDIP (abbreviation in French)

AMLA or Anti-Money Laundering Act – Swiss Federal Act on Combating Money Laundering and Terrorist Financing, 10 December 1997

ASA – Swiss Arbitration Association

ASA Bull. – Bulletin of the Swiss Arbitration Association

Banking Act – Swiss Federal Act on Banks and Savings Banks, 8 November 1934

BIT – bilateral investment treaty

CAS – Court of Arbitration for Sports, Lausanne, Switzerland

CC – Swiss Civil Code of 10 December 1907 (abbreviated in German «ZGB»)

CISG – United Nations Convention on Contracts for the International Sale of Goods, 11 April 1980, Vienna

CJEU – Court of Justice of the European Union

CO – Swiss Federal Act on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations), 30 March 1911

Community – European Community (succeeded by the European Union)

cons. – consideration

Court – (unless something else is specified) Swiss Federal Supreme Court

CPC – Swiss Civil Procedure Code, 19 December 2008

CrimC – Swiss Criminal Code, 21 December 1937

DIAC – Dubai International Arbitration Centre

DIAC Arbitration Rules – Arbitration Rules of the Dubai International Arbitration Centre, 2007

Diss. – dissertation (from the German word «Dissertation»)

DSC – Decision of the Swiss Federal Supreme Court

GCC – German Civil Code (abbreviated in German «BGB»)

EC – European Community, Community (succeeded by the European Union)

ECHR – European Convention on Human Rights, 4 November 1950, Rome, as amended by Protocols Nos. 11 and 14 supplemented by Protocols Nos. 1, 4, 6, 7, 12 and 13

ed. – edition

Ed. – editor

Eds. – editors

EEC – European Economic Community, European Community, Community (succeeded by the European Union)

EEC Treaty – Treaty establishing the European Economic Community, 25 March 1957, Rome

etc. – etcetera, and so on, and so forth

et seq. – and that which follows

et seqq. – and those which follow

EU – European Union

f. – and the following page

ff. – and the following pages

FMIA or Financial Market Infrastructures Act – Swiss Federal Act on Financial Market Infrastructures and Market Conduct in Securities and Derivatives Trading, 19 June 2015

fn. – footnote

Hague Principles on Choice of Law – Principles on Choice of Law in International Commercial Contracts of the The Hague Conference on Private International Law, *19 March 2015*

HKIAC – Hong Kong International Arbitration Centre

i.c. – *in casu*, in that case

ICC – International Court of Arbitration of the International Chamber of Commerce

ICC Rules – Rules of Arbitration of the International Chamber of Commerce, 2017

ICDR-AAA – International Centre for Dispute Resolution of the American Arbitration Association

ICDR-AAA Rules – International Arbitration Rules of the International Centre for Dispute Resolution of the American Arbitration Association, 2014

ICSID – International Centre for Settlement of Investment Disputes, Washington D.C., U.S.

ICSID Convention – Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, Washington

IMF – International Monetary Fund

Inter-American Convention – Inter-American Convention on International Commercial Arbitration, 30 January 1975, Panama

IPRG – Swiss Private International Law Act, 18 December 1987, abbreviation in German; also referred to as «Act», «PILA» (abbreviation in English) or «LDIP» (abbreviation in French)

ISDA – International Swaps and Derivatives Association

ISDA/IIFM Tahawwut Master Agreement – International Swaps and Derivatives Association/International Islamic Financial Markets Tahawwut (Hedging) Master Agreement, 1 March 2010

Law 12(I)/2013 – Cypriot Enforcement of Restrictive Measures on Transactions in Case of Emergency Law, 2013

LCIA – London Court of International Arbitration

LCIA Arbitration Rules – Arbitration Rules of the London Court of International Arbitration, 2014

LDIP – Swiss Private International Law Act, 18 December 1987, abbreviation in French, also referred to as «Act», «PILA» (abbreviation in English) or «IPRG» (abbreviation in German)

MIT – multilateral investment treaty

N – paragraph in a Swiss commentary on a legal act (from the German «Note» – note, remark)

New York Convention – the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958, New York

No. – number

p. – page

para(s) – paragraph(s)

PILA – Swiss Private International Law Act, 18 December 1987, LDIP, also referred to as «Act», «IPRG» (abbreviation in German) or «LDIP» (abbreviation in French)

P.R.I.M.E. Finance – Panel of Recognized International Market Experts in Finance

P.R.I.M.E. Finance Arbitration Rules – P.R.I.M.E. Finance Arbitration Rules, 2016

RabelsZ – Rabels Zeitschrift für ausländisches und internationales Privatrecht, Max-Planck-Institut für Ausländisches und Internationales Privatrecht, 1961– (The Rabel journal of comparative and international private law)

Rome I – Regulation (EC) No 593/2008 of the European Parliament and of the Council on the law applicable to contractual obligations, 17 June 2008

Rome II – Regulation (EC) No 864/2007 of the European Parliament and of the Council on the law applicable to non-contractual obligations, 11 July 2007

Rome Convention – Rome Convention on the Law Applicable to Contractual Obligations, 19 June 1980, Rome

SEC – US Securities and Exchange Commission

Sec. – Section

SESTA – Swiss Federal Act on Stock Exchanges and Securities Trading, 24 March 1995

SIAC – Singapore International Arbitration Centre

SIX – SIX Swiss Exchange Ltd.

SIX Rule Book – SIX Swiss Exchange Ltd. Rule Book, 15 July 2016

SRO – self-regulatory organisation

Swiss Rules – Swiss Rules of International Arbitration of the Swiss Chambers' Arbitration Institution, June 2012

TFEU – Treaty on the Functioning of the European Union

UNCITRAL – United Nations Commission on International Trade Law

UNCITRAL Arbitration Model Law – UNCITRAL Model Law on International Commercial Arbitration, 1985 with amendments as adopted in 2006

UNCITRAL Arbitration Rules – UNCITRAL Arbitration Rules, with new article 1, paragraph 4, as adopted in 2013

v – versus

Vol. – Volume

YCA – Yearbook Commercial Arbitration, International Council for Commercial Arbitration, 1976-

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Introduction

Chapter 1: The problem

1 Recently, more and more national legislatures have been producing rules that qualify as being within the private international law concept of overriding mandatory rules. Accordingly, international arbitrations, which operate in the realm of private international law, have increasingly had to deal with such rules. The (topical) international arbitration of disputes related to financial transactions is particularly susceptible to this tendency, since financial transactions are often regulated through this type of rule.

2 Swiss international arbitration seems not to be prepared for dealing with overriding mandatory rules. It treats them controversially, leaving many basic issues open. Is a Swiss international arbitrator allowed to give effect to overriding mandatory rules? If yes, is he or she also obliged to do so? Where such an obligation is affirmed, should it be complied with *ex officio* (*sua sponte*) or upon invocation by a party? Whilst it is felt that for Swiss international arbitrators a full disregard of overriding mandatory rules is nowadays not an option as well as that these adjudicators show more willingness to apply such rules and that they are empowered to do so[1], there is no firm legislative or jurisprudential basis for this yet. At the same time, clarity is paramount to Switzerland, since the latter is a popular choice as a seat of international arbitrations[2]. Lucidity over the addressing of financial overriding mandatory rules in particular is even more important given that, in addition to its role as an international arbitration centre, Switzerland represents a financial hub. Against the background of this combination, the country is likely to be hosting quite a number of the potentially upcoming international arbitrations on financial

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[1] KAUFMANN-KOHLER/RIGOZZI, 7.95 and the references there; SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 314; SCHNYDER, Wirtschaftskollisionsrecht, 340 and the references there; VOSER, Mandatory rules, 330.

[2] Pursuant to statistics of ICC, Switzerland is the most popular country for international arbitration proceedings conducted under the arbitration rules of that institution – see HONEGGER/EISELE/LIVSCHITZ. Among the reasons for this positive development are legislation which is friendly towards international arbitration and the large court practice in the area.

transactions[3]. In fact, creation of legal certainty in this respect might even attract more of these international arbitrations to Switzerland.

[3] Similarly – WERLEN.

Chapter 2: The present work

3 Using the example of financial overriding mandatory rules, this work explores the possibilities for defining the status in Swiss international arbitration of overriding mandatory rules through reliance on the current legislation. It concludes on the shortcoming of these possibilities and proposes the enactment in Chapter 12 PILA of new rules which prescribe what effect overriding mandatory rules should «produce» within international arbitration.

4 The text will first explain the characteristics of Swiss international arbitration and the situations in which the latter might involve financial overriding mandatory rules. It will then sketch the process of determining the law applicable in Swiss international arbitration. Following this, the phenomenon of overriding mandatory rules, with some examples from the financial sphere, will be presented. The last (but not at all the least) part will analyse the core of the problem – the role of overriding mandatory rules, taking as an example financial overriding mandatory rules, in Swiss international arbitration.

Chapter 3: Terminological remarks

5 Unless something else is specified, «commercial» will be understood as something that is done for profit. In this (wide) meaning, that term will encompass both «financial» and «non-financial» activities done for profit. This concept will have at least two important consequences for the present analysis. First, the latter will understand commercial arbitration as arbitration that deals with both: disputes of the non-financial (real economy) sector – disputes over non-financial transactions; and disputes of the financial sector – disputes over financial transactions and over transactions supporting financial transactions. Hence, commercial arbitration will include non-financial arbitration and financial arbitration or, in other words, financial arbitration will be a type of commercial arbitration. That understanding is different than the concept encountered in the new literature on financial arbitration which perceives the latter as an alternative, rather than a type, of commercial arbitration. Apparently, this concept comprehends «commercial» more narrowly as equal to «originating from the real economy» i.e. as opposite to «financial». Because in the present work «commercial» will mean «done for profit», no contradiction will occur when literature on commercial arbitration is cited which dates from the time before financial arbitration became a hot topic – such literature will still be applicable as it will concern arbitration of which the new financial arbitration is a part. Second, a commercial contract will include both – a contract with a financial subject matter and a contract with a non-financial subject matter – so that a financial contract, as long as it is (like that one delved into here) done for profit, will represent a type of, not an alternative to, a commercial contract.

6 «Conflict law», the system of conflict of laws rules, is, so to say, a *meta* law: it defines the applicability of other law. It is here believed that every law necessitates a conflict of laws rule (whether explicit or implicit)[4]. There are two types of conflict law: conflict law that regulates the applicability of a domestic law to a domestic case (domestic conflict law) and conflict law which governs

[4] Which conflict of laws rule would render such a conflict of laws rule applicable is another question, which is (fortunately) outside the scope of the current work.

the applicability of a domestic or foreign law to an international case (international conflict law). Relevant for the present topic is solely the international conflict law and, in fact, solely the part of it which addresses the applicability of a domestic or foreign law to an international private law case (as opposed to an international public law case); a part utilised in private international law, or private international conflict law. In the absence of a specification otherwise or unless the words of others are conveyed or cited, solely this private international conflict law will be kept in mind when speaking here of «conflict law» respectively «conflict of laws rules».

7 «Court», if not preceded by a word which indicates something else (such as the word «arbitration») will mean «state court».

8 Strictly speaking, the substantive law of the forum can be called «domestic law» only when the forum is a state court but not if it is an arbitration court because the latter court is not so strongly related to the forum's law as for such law to be called a «home» («domestic») law. However, in order to facilitate comparison between the relation of an arbitration court to the law of its seat and the relation of a state court to the law of its seat (a comparison which might be necessary here), the term «domestic law» will be used to signify also the law of the seat of an arbitration court.

9 «Effect» of a (legal) rule respectively of a law will mean application or consideration of such a (legal) rule respectively of such a law.

10 «Financial dispute» will signify a dispute relating to a financial transaction in particular. It will not cover a dispute arising out of a non-financial transaction, even if the claims raised are financial, i.e. monetary.

11 Unless something else is specified, «international arbitration» will here have the narrow sense of international commercial arbitration.

12 «Judge» will equal to «state judge», unless preceded by a word implying something else such as «private».

13 The term «*lex fori*», which signifies the law of the country in which a forum is seated, will be used here in its widest meaning. On the one side, it will refer to the law of any forum – a state or an arbitration court – and not (like in some

other academic writings) solely to the law of a state court. Strictly speaking, a forum is a body which delivers a legally binding decision on a particular factual matter, and both forums – a state and an arbitration court – are such bodies; the fact that an arbitration court functions in a way different than a state court does not change that. Besides, the term which pretends to signify the law of an arbitration court in particular – «*lex fori arbitri*» – also contains the word «*fori*». Hence, «*lex fori arbitri*» should be understood as a type of «*lex fori*», the latter encompassing the law of a state court (which could, for example, be called «*lex fori imperi*») and the law of an arbitration court (the «*lex fori arbitri*»). On the other side, «*lex fori*» will cover not only those rules of the law of the forum which are binding on the international arbitration but also those that are not, i.e. it will include the law of the forum in its entirety. No confinement to the binding part of the law can be inferred from the expression «*lex fori*»: the latter speaks only of a «*lex*» without specifying a particular type of *lex.*

The terms «private international law» and «international private law» are deemed to have the same meaning and will be used as such. 14

«Private judge» will be a synonym of «arbitrator». 15

«Private law person» shall include not only creatures of private law but also those of public law when they act as private law persons – e.g. states participating in commerce (*acta iure gestionis*)[5]. *Vice versa*, «public law person» shall include private law persons which exercise public law powers – e.g. stock exchanges deciding whether to admit securities to trade. 16

«Public law» in the English-inspired systems is administrative (or regulatory) law; law related to the powers and actions of governmental and public entities and to the remedies available in connection to such powers and actions. The concept of the civil (continental) legal system is broader – it comprises the law of subordinate relationships[6] and thus not only administrative (or regulatory) 17

[5] – as opposed to them exercising their sovereign powers (*acta iure imperii*).

[6] – relationships in which one of the parties has the legal power to coerce the other party to undertake particular (active or passive) behaviour.

but also criminal law. The current thesis adopts this broader, civil law definition.

18 «Transaction» can be understood in a wide sense as a system of contracts which are related to each other (though remaining separate contracts) and in a narrower sense as one contract. Here, the latter will be used.

19 Where it is not specified to which legal act a provision, a section or a chapter belongs, that act will be PILA.

Part 1: International arbitration

Chapter 4: International arbitration

I. International arbitration as a type of arbitration

20 Arbitration is a consensual method of dispute resolution within which the decision is rendered by a special body – an arbitration court – which does not adjudicate in the name of a state. A dispute is resolved in a legally binding manner (dispute resolution) and such legal bindingness is freely agreed on in advance – whether before or after the occurrence of the dispute – by the parties (consentaneity). Arbitration is an alternative to litigation. The latter is dispute resolution which is legally binding regardless of whether the parties have consented to this legal bindingness of it or not (i.e. it is a non-consensual dispute resolution) and it takes place before a state court which adjudges in the name of a state[7].

1. Domestic arbitration

21 Domestic is the arbitration which does not feature any international element.

1.1 Domestic public law arbitration

22 Domestic public law arbitration deals with disputes that evolve within one jurisdiction and concern public law relations (relations in which one of the parties is subordinate to the other). This arbitration is a rarity because in domestic cases, where they have sovereign powers over the counterparty, public law parties (e.g. states or authorities representing them) prefer state courts and do

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[7] In fact, the term «litigation» has also a wide meaning as dispute resolution in general, i.e. as dispute resolution delivered by both – state courts or arbitration tribunals. However, since this wide meaning of «litigation» does not seem to be very precise – strictly speaking «litigation» is dispute resolution resting on rules of law, whereas in arbitration the dispute resolution can sometimes (where the parties have authorised the arbitral tribunal to decide *ex aequo et* bono) be based on the rules of another social system, e.g. on *bonos mores* – the narrow meaning of «litigation» will be used here, except where citing (when respective clarification will be provided). Furthermore, the narrow meaning of «litigation» is more often encountered in the recent literature and practice.

not consent to arbitration[8]. One of the few examples is the SIX arbitration[9] (which will be discussed briefly below but which does not come within the scope of the current work).

1.2 Domestic private law arbitration (domestic commercial arbitration)

Domestic private law arbitration, or domestic commercial arbitration, is that domestic (under Swiss law, when both parties have their domicile or habitual residence in Switzerland at the time of the arbitration agreement's conclusion – Art. Art. 353 (1) CPC in conjunction with Art. 176 (1) PILA) arbitration which addresses disputes between private law parties – parties that are equal to each other. This is the classical domestic arbitration. 23

2. International arbitration in a wide sense

International arbitration is that which includes some cross-border element. 24

2.1 International public law arbitration

International public law arbitration is the arbitration through which public law persons belonging to different jurisdictions settle disputes related to their public law powers, such as where states arbitrate border disagreements. Since these persons are equal parties and since they, especially states, are politically reluctant to subject themselves to the court of a foreign jurisdiction, they (in fact, frequently) resort to arbitration. 25

2.2 International arbitration (international arbitration in a narrow sense, international commercial arbitration)

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[8] For instance, *Rapport Final,* 36, 37 confirms the reluctance of financial regulators (who have a relevant role for the overriding mandatory rules taken as an example here – financial overriding mandatory rules) to arbitrate.

[9] – on the premise (mentioned above) that private law persons with public law functions, such as namely SIX, are perceived as public law persons.

International arbitration (international arbitration in a narrow sense, international commercial arbitration, international private law arbitration) is that international (under Swiss law, when at least one of the parties does not, upon concluding the arbitration agreement, have its domicile or habitual residence in Switzerland (Art. 176 (1) PILA)[10]) arbitration which serves for settling disputes between private law persons.

27 The present work will explore this type of international arbitration. References to «international arbitration», «international arbitration court», «international arbitrator», etc. should be understood as references respectively to it, to an arbitration court accomplishing it, to an international arbitrator adjudging in it, etc.; this is valid accordingly also for the plural forms of these terms.

28 According to the method of organisation, international arbitration can be institutional or *ad hoc*. Institutional international arbitration is that which is administered by an arbitration institution. The latter receives the claim and the response, takes deposits, arranges facilities for the hearings, etc[11]. Some prominent arbitration institutions include the Swiss Chambers' Arbitration Institution, the International Court of Arbitration of the International Chamber of Commerce (ICC) or the London Court of International Arbitration (LCIA). *Ad hoc* international arbitration is not administered by an arbitral institution. It is more flexible, but, accordingly, requires more organisational steps by the parties. Depending on the sort of controversy being resolved, one can speak of

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[10] The Swiss legislator does not seem to confer any relevance on the fact of whether, apart from the difference between the Swiss place of seat and the non-Swiss place of domicile or habitual residence of (at least) one of the parties, any other «internationality» is featured by the case. This follows from the language of Art. 176 (1) PILA as well as from the jurisprudence and literature – according to the latter in Art. 176 (1) PILA, the legislator did not care about the internationality of the substance of the case (but undertook a «formalistic» approach) – see *DSC 4P.115/2003 of 16 October 2003*, cons. 2.1 as referred to and translated by KAUFMANN-KOHLER/RIGOZZI, 2.28, 2.29. Hence, it is not necessary, for example, that the domicile or habitual residence of one of the parties is different from the domicile or habitual residence of the other party or that coinciding places of business of the parties differ from the place of the transaction's performance; as long as this is not Switzerland, the dispute's substance might even involve only one jurisdiction.

[11] The arbitral institution is a body different than the arbitral tribunal: it only administers the case, whilst the latter renders the decision (the arbitral award).

international construction arbitration, international oil and gas arbitration, and (since quite recently) international financial arbitration, etc.

2.3 International investment arbitration (investment arbitration)

29 International investment arbitration, or simply «investment arbitration» (an investment arbitration is by default international as it is conducted between parties from different jurisdictions) handles the claim of a private law person against a state, whose nationality such a private law person does not hold, relating to the treatment by that state of their (the private law person's) investment in the territory of that state. The state («host state») will have concluded a treaty with another state («home state») or other states (each «home state») – a bilateral investment treaty (BIT) or a multilateral investment treaty (MIT) respectively – under which it is obliged to protect in certain ways particular investments made in its territory by investors who are nationals of such other state(s), e.g. it is obliged to make tax exemptions in relation to such investments[12]. It is the manner in which, and whether at all, the defendant has complied with these undertakings that is scrutinised in an investment arbitration.[13] Investment arbitration constitutes a special mixture between international public law arbitration and international arbitration; the only international arbitration in the wide sense that is of such a mixed type. It reveals a public law nature because one of the parties (the host state) has sovereign powers[14] to regulate the behaviour on its territory of the other party. At the same time, there is certain equality between the «rivals» in the procedure, hence a private law nuance, for the party with coercive competence (the host state) has undertaken its obligation as a coequal – in an agreement (with the home state).

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[12] The BIT or MIT is, thus, similar to a third-party beneficiary contract – through it the contractors create rights for a third person.

[13] The investor is legitimised as a party to the arbitration, even though it did not sign the BIT or MIT (the home state did) because, when covenanting the arbitration, the BIT or MIT created for the investor an option to arbitrate, which the latter accepts when initiating the arbitration (again as if a third-party beneficiary contract was signed).

[14] Not only, but also, due to the involvement of some public law elements, the decisions in investment arbitration are published.

30 Investment arbitration is not taken into the scope of the current work, even if it has some elements of international arbitration. In any case, overriding mandatory rules are not so relevant in this type of arbitration. First, unlike in international arbitration, the applicable law is clear – the BIT or the MIT[15]. Second, though sometimes one will deal with overriding mandatory rules (when the host state's rules that allegedly violate the BIT or MIT represent overriding mandatory rules), the position of such overriding mandatory rules will be different. The arbitrator will not, like in international arbitration, be deciding on their applicability or ability to be considered – it will be certain that they will be applied (they will even have already been applied – not by the arbitrator but by the defendant); the arbitrator will be deciding on their (in)compatibility with the host state's obligations under a treaty[16].

II. Arbitrability

31 Arbitrability is the principal possibility recognised by law that a dispute on a particular matter (objective arbitrability, or arbitrability *ratio materiae*[17]) and between particular parties (subjective arbitrability, or arbitrability *ratio personae*[18]) is resolved in a legally binding manner through arbitration such as through international arbitration[19]. Certain relations, e.g. non-pecuniary relations, will be considered inappropriate to be adjudicated by arbitrators and, thus, will be reserved for courts. Then, law might prohibit some categories of persons from arbitrating – e.g. state companies; however, it is to be noted that,

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[15] EULER/BIANCO, 561 seem to express a similar view. When reflecting which is the better forum for vulture funds that have bought sovereign debt – investment arbitration or non-investment arbitration – they point out that investment arbitration offers more certainty with regard to applicable law, the applicable law in non-investment arbitration being, *inter alia*, «limited by the mandatory rules of the law of the seat … and public policy».

[16] – admittedly not the rules «in themselves but the extent to which they may violate specific commitments» will be what the investment arbitrator will examine, but still there will be some scrutinisation of the rules themselves. See *CMS Gas Transmission Company v The Republic of Argentina, ICSID case N. ARB/01/8, 17 July 2003, Decision of the Tribunal on Objections to Jurisdiction*, para 27.

[17] HANOTIAU, 33.

[18] HANOTIAU, 33.

[19] See also HANOTIAU, 33.

since such prohibitions are rarely valid outside the countries imposing them (in Switzerland e.g. they are not due to Art. 177 (2) PILA), they seldomly become an issue in international arbitration.

Arbitrability is not a problem of substance. Even if it presupposes evaluation of the type of substance (e.g. pecuniary or not), it does not require (nor does it allow) the rendering of a decision on the merits. The arbitrability check comprises only an examination of whether the objective law permits that the category of disputes, to which the submitted dispute belongs, are arbitrated, and that the type of parties, to which the parties that have submitted the dispute belong, arbitrate. Substantive matters like limitation periods, waivers of rights or the here-discussed substantive overriding mandatory rules are decided later (and only if arbitrability is affirmed). 32

In Switzerland, arbitrability for the purposes of international arbitration is regulated in Art. 177 PILA. With regard to objective arbitrability, the first paragraph of that article provides that all pecuniary matters are arbitrable, which is considered a liberal approach. Art. 177 (1) PILA is a substantive norm – not in the sense that it deals with a substantive issue (it does not; it deals with a jurisdictional matter – arbitrability) but in the sense that it is not a conflict of laws rule. Because of this quality of this norm, objective international arbitrability is decided according to it and hence according to Swiss law; a foreign law can play a role only by way of exception if featuring a status of *ordre public* within the meaning of Art. 190 (2) (e) PILA[20]. 33

The (liberal) content of Art. 177 PILA combined with its «substantiveness» renders Swiss international arbitrability resistant to the involvement of (the here-analysed) substantive overriding mandatory rules, i.e. cases which have the potential of turning out to be governed by such rules will be admitted to international arbitration in Switzerland[21]. Such resistance is anyway appropriate generally. Firstly, an argument that in international arbitration there is a 34

[20] The Court in *dictum* in *DSC 4A_388/2012*, cons. 3.3. An overriding mandatory character of such a foreign rule on arbitrability will apparently not suffice.

[21] *DSC 118 II 353 from 23 June 1992*. Also SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 312 underlines that the jurisprudence on Art. 177 PILA leads

higher risk (than in international private law state court proceedings) of evasion of overriding mandatory rules cannot be raised in favour of inarbitrability because the issue of evasion of overriding mandatory law (and of any other law) is a part of the merits, in particular of the determination of applicable law, and not a part of the question on arbitrability. Rather than prohibitting the whole international arbitration process, one should embed a protective mechanism into the stage at which the dispute's substance is adjudged upon. Second, it is far from being certain that international arbitrators would tolerate circumvention of overriding mandatory rules. Third, exemption (from international arbitration) of all disputes in relation to which overriding mandatory rules might be applied or considered entails the risk of «*vice versa* circumvention»: *mala fide* avoidance of international arbitration through excessive invoking of the relevance of overriding mandatory rules. Fourth, the frequently agreed-on confidential character of the international arbitration does not automatically lead to evasion of law because anonymised disclosure is still possible.

III. Arbitration agreement

35 Arbitration agreement in its wide sense (used here) incorporates the consent of the parties to arbitrate a dispute. It can take the form of a separate contract whose only aim is the submission of the dispute to international arbitration (arbitration agreement in a narrow sense) or, more frequently, of a clause of a contract governing not only such submission but also, and actually primarily, the relationship giving rise to the dispute (arbitration clause).

IV. Seat

36 International arbitration has its seat in a particular state (usually in a certain city within it, as stipulated in the arbitration agreement). The seat has legal functions. It sets the rules applicable to the international arbitration: if these are not complied with, the international arbitration is of no legal force or at least «annullable». The seat's courts have certain competences – e.g. namely

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to more frequent dealing by international arbitration seated in Switzerland with foreign overriding mandatory rules.

to annul the resulting arbitral award, to decide on parties' challenges of the arbitrator(s), etc. Then, the seat plays a role for the recognition and enforcement of the award, for this is considered to have been issued in it.

V. Finality

An international arbitral award is in principle final – Art. 190 (1) PILA. Only limited grounds listed in Art. 190 (2) PILA can lead to its annulment. 37

VI. Enforceability[22]

A Swiss international arbitral award is directly enforceable in Switzerland. The procedure envisaged in Art. 193 (2) PILA is not a true enforcement procedure: it is not mandatory and it takes place without the participation of the counterparty. In a state other than Switzerland, the award will undergo a true enforcement procedure. Where this other state is a signatory to the New York Convention, such a procedure will be very simplified as, with few exceptions in its Art. V, that Convention compels enforcement of awards originating from another contractor, which Switzerland is. Since, in fact, a great number of countries (as many as 159) are parties to the Convention, Swiss arbitral awards have great enforceability abroad. 38

VII. Non-state adjudication

The idea of international arbitration is to represent an alternative to a state court as the deliverer of justice for international private law disputes. This concept manifests, amongst other things, in the following. First, unlike a state court, an international arbitral court is not an organ of the state in which it is seated (or of any other state)[23] and it does not render its award on behalf of 39

[22] Since enforcement of the award presupposes its recognition, where the terms «enforcement», «enforceability», «enforcing», «enforce», etc. are used here, «recognition», «recognisability», «recognising», «recognise», etc. is also meant.

[23] That is why, while the law of the seat of a state court can be defined as «the law of the place before *whose* state court … a dispute is adjudged and decided» (BERTOLF, 1, own translation* from German, emphasis added), the law of the seat of an arbitration court cannot be

this (or of any other) state. Second, whilst state courts that resolve international private law cases are permanently seated in a certain country (the one they represent), international arbitration courts are not[24]. The seat of the international arbitration court is a seat only during the conduction of the concrete arbitral procedure. Third (and a direct consequence of the second), a state court examining an international private law controversy has a home jurisdiction – the seat – but an international arbitration court does not. That is why Art. 190 (2) (e) PILA, which applies to the latter, does not protect the Swiss, but the international, *ordre public*. For international arbitrators, any jurisdiction, including the seat, is foreign (their indigenous point of view is some universal mindset)[25]. They are «sheltered» by the law of the seat and the law governing the substance only during the respective procedure – until the dispute is resolved. Moreover, the seat's law «hosts» merely with regard to the conflict of laws and procedural, but not the substantive, questions (providing rules on the latter would often not even make sense because the facts would not be connected to the seat[26]).

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called something like «the law of the place before *whose* arbitration court a dispute is adjudged and resolved». (* The phrase «own translation» in this dissertation refers to a translation made by the dissertation author.)

[24] Since, as clarified above, such an institution is to be distinguished from such a court, the permanent seat of an arbitration institution is not the permanent seat of the arbitration court which such an institution assists.

[25] MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 28; CHRISTEN, 20.

[26] Such a seat would be a «disinterested forum» – it would not want to apply. See KARRER, BSK IPRG, Art. 187 N 231.

Chapter 5: International arbitration in finance

Financial overriding mandatory rules – the example of overriding mandatory rules taken here – will be mostly relevant in international arbitration in finance (international financial arbitration). This is international arbitration which deals with financial transactions or with transactions that directly or indirectly support the conclusion of financial transactions (e.g. agreements for the distribution of financial products or the integration of the businesses of financial services providers). 40

Subchapter 1: Financial transactions

I. Definition

In a wide meaning, a financial transaction can be understood as a contract which involves (in any way) the provision of financial means. Narrowly, a financial transaction is a contract for the provision of financial means (against consideration). The provision of financial means is the *causa* – the goal – of such a contract[27]. Agreements which trigger the providing of financial means but whose main goal is not such providing but something else – e.g. sales contracts under which a price is paid as a consideration for the transfer of property, where the transfer is the main objective – will not be financial transactions within this narrow meaning; only in the wide sense. In the present work, the narrow sense is used. 41

One may speak also of «financial contract», «financial agreement», «financial relationship» and «financial instrument» and still mean «financial transaction»[28]. The differences between these terms and the latter are not significant 42

[27] Whether the party obtaining the financial means has a further objective regarding their use does not change the fact that the goal of the concrete transaction is the provision of financial means.

[28] Similarly, SEBASTIANUTTI, International financial law, Part 3 talks about «financial instrument, transaction or relationship», and not only about «financial contract».

for the subject matter of the current analysis. «Financial contract» and «financial agreement» are, anyway, synonyms of «financial transaction». «Financial relationship» is the legal relationship created through the conclusion of a financial transaction. The concept of financial instrument must be addressed with more caution because its legal meaning has not been completely clarified. It can be understood: first, as a synonym of financial transaction; second, as a form in which the financial market's «goods» are marketed, i.e. a financial product or a legally construed title (usually fungible and easy to transfer[29]) which, even if put into a legal frame, has a rather economic connotation; and third, as a type of financial transaction – specifically a more complex financial transaction whose subject matter is not directly the provision of financial means but the provision of a deliverable whose subject matter is the provision of financial means (e.g. a derivative). For simplicity (which can be afforded here, since the main focus of the work is elsewhere), «financial instrument» will be used in its meaning as a financial transaction.

43 Financial means are nothing else but money. Therefore, the characteristic obligation under a financial transaction is an obligation for the transfer[30] of money. Delivered is either money or a right in receiving money. This is so even where (e.g. in a derivative contract) «physical delivery» is stipulated – in the financial markets' *lingua franca*, this expression means the actual delivery of a sum of money whose size is derived from the value of an underlying commodity, and not the delivery of the good. The monetary nature of the obligations created by financial transactions has certain implications because there are different legal regimes, both on a private law and public law level, for monetary and non-monetary obligations. By way of example, some private law justifications for a failure to comply with non-monetary obligations would not be available for excusing non-fulfillment of monetary obligations. On a

[29] LEHMANN, 25-27.

[30] When defining a financial transaction, SEBASTIANUTTI, International financial law, Part 3, 248 speaks of an obligation «for the payment or transfer» of money. The distinction between «payment» and «transfer» of money is considered here unnecessary because the former is a type of the latter.

public law level, specific policies such as currency controls will apply to monetary obligations.

Mergers and acquisitions are, here, not considered financial transactions. They do not have as their goal the provision of financial means; they aim for the change of control over a company – full transfer (acquisition) or partial transfer (merger). That renders them an issue of corporate law rather than financial markets law. It is true that mergers and acquisitions go along with the conclusion of financial transactions, but such financial transactions only support the merger or the acquisition, e.g. by enabling the payment of the purchase price. The purchase of shares in an acquisition is different than the purchase of shares on the financial market: first, the acquirer has the objective of acquiring control over the company, whilst the financial market's investor seeks to finance the company and to make a profit (from subsequent reselling of the shares at a higher price or from the dividends to which the shares entitle); second, apart from the ownership in it, the acquirer obtains rights to actively manage the company, whereas the buyer of shares on the financial market usually does not; third, through paying the purchase price the acquirer does not, like a financial market's investor, «finance» the company – they «finance» the persons selling the company; fourth, the acquirer will purchase some significant percentage of shares – only in that case there will be a change in the control of the company (acquisition) – whilst an investor might buy a small number of shares. Since mergers and acquisitions are not seen as financial transactions, examples of international arbitrations involving them were not specifically sought and are included in the present analysis only as far as some financial markets rule has been relevant; moreover, since it occurs frequently[31], international arbitration in mergers and acquisition has already been sufficiently explored in the literature. 44

II. Examples

Often expressions like «banking and finance» or «banking and financial transactions» are encountered. In these, the concept of finance is used in some sort of a narrow sense as encompassing only those financial transactions which are 45

[31] EHLE, 287.

carried out by a financial market actor different than a bank. Probably the fact that the largest part of the dealings in finance is executed by banks prompted such treatment of banking as a branch separate from and parallel to finance. Yet, strictly speaking, banking transactions are a type of financial transactions and it is more appropriate to speak of financial transactions which are divided into banking transactions and non-banking transactions. In fact, such a classification of the financial transactions into banking and non-banking transactions has no consequences for the topic discussed here; the ordering of the examples of financial transactions below according to it is only for keeping a structure.

1. Banking transactions

46 Banking transactions include traditional banking transactions (receiving deposits from and granting credits to clients), transactional banking (financial support for reciprocal exchanges of goods, monetary flows or commercial papers executed by clients) and investment banking (supporting institutional clients e.g. through underwriting securities issued by them).

47 This is a rather economic classification of the activities of a bank. To make a legal one is quite difficult. On the one hand, laws do not give a basis for that. On the other hand, in practice, bankers often use terms which do not reflect legal concepts. For instance, in a legal *sensu stricto*, every banking is commercial, because in its precise meaning the latter term signifies something that is done for profit – and every banking is done for profit. However, the banking practice makes a classification of banking by using «commercial» in two other (with regard to the true meaning) narrower meanings: first, it understands «commercial banking» as banking that is not investment banking (i.e. as non-investment banking) – it namely divides banking into commercial and investment banking[32] – and, second, it sometimes understands «commercial banking» as only one type of non-investment banking (rather than as any non-investment banking) – that which is done with corporate clients.

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[32] This is probably the most popular division of banking activities, and in any case is one of practical relevance, as a bank's work is organised according to it (the departments responsible for commercial banking and for investment banking are separate).

1.1 Commercial banking in a wide sense

Commercial banking in a wide sense, as already mentioned in the previous paragraph, is non-investment banking, i.e. it is traditional and transactional banking taken together. As can be inferred again from the previous paragraph, based on the nature of the client, commercial banking in a wide sense is divided into retail banking (consumer banking, personal banking) and commercial banking in a narrow sense (corporate banking, business banking). 48

a Retail banking (consumer banking, personal banking)

Retail banking is that commercial banking in a wide sense which is done with retail clients. «There is very little cross-border banking that involves consumers»[33]. The needs of its clients are associated with a rather modest amount of capital one can gather on the local market and with daily matters (payments of bills, withdrawing of cash, etc.) mostly arranged within the client's country of residence. Thus, any dispute resolution will usually be accomplished within the relevant country, and Swiss international arbitration will rarely have to deal with such transactions. 49

b Commercial banking in a narrow sense (corporate banking, business banking)

Commercial banking in a narrow sense is that commercial banking in a wide sense which is done with corporate clients. Such corporate clients can be private law persons but also creatures of public law, including sovereigns. They can range from small businesses through to middle-sized and big businesses operating in any part of the economy (including finance). Corporate banking can be both national and international. In the first case, the client is a local company operating within national borders; in the second, it is an entity active in various countries or in one country but in need of large financing obtainable only by accessing the international capital markets. 50

1.2 Investment banking

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[33] GUZMAN/SYKES, 386.

An investment bank does not perform retail banking services. Its clients are, for example, companies, other financial institutions, pension funds, hedge funds, and governments.

52 Investment banking includes, in the first place, assistance for companies to take new issues of securities in an initial public offering or in follow-on offerings to the market. Here the bank acts as an intermediary between the securities' issuer and the investors. Its activities consist, *inter alia*, of pre-underwriting counselling, underwriting (buying all the issued securities at a set price and reselling them to the public, mostly to institutional investors, or acting as an agent for the issuer in selling the securities against a commission) or advising after the distribution. Other activities of investment banking are the facilitation of transactions such as mergers and acquisitions or other corporate reorganisations. Project financing is a part of investment banking as well. Then, investment banks broker to or trade for the accounts of clients (mostly institutional clients but also individuals – the so-called high-net-worth individuals) and trade on their own account with securities, indices, etc.[34]. Perhaps the most important area of investment banking is the conclusion of derivatives contracts. Investment banking is very international. Accomplishing one of its main missions – to connect persons in need of capital with persons holding superfluous capital – necessitates access to as much capital as possible, hence, to as many capital markets as possible, or to the capital markets of as many countries as possible. That is why investment banking transactions are likely to be the banking transactions most often brought to international arbitration.

2. Non-banking financial transactions

53 Non-banking financial transactions are those concluded by insurers and reinsurers, hedge or vulture funds, etc. – all participants in the financial market which are not banks.

III. Multi-jurisdictionality

[34] Because the simultaneous performance of advisory and trading activities by a bank can lead to conflicts of interests, separate advisory and trading divisions are instituted in it (building of «Chinese Walls»).

Financial transactions have become immensely international, given that their subject matter – financial means – is easily transferrable across borders (especially because it nowadays exists mostly in an electronic form), and given that globalisation has had a sensible impact[35] on them. For such transactions, that implies regulation by many jurisdictions since, whilst business no longer knows any boundaries, law still does[36]. There is some harmonisation[37] which globalisation has brought about, e.g. harmonisation of certain types of financial contracts through the adoption of model agreements or the unification of practice, but the competence to enact legislation still lies with national legislators and the original competence, i.e. the competence which does not necessitate consent by the parties, to resolve disputes in a legally binding manner – with national courts. 54

IV. Systemic nature

Financial transactions are of a systemic nature – the destiny of one financial transaction can influence the destiny of another. For instance, since a bank lends «the»[38] money which depositors deposit with it to others (borrowers), if too many of the latter fail to return the borrowed money to it and too many of the depositors request from it their deposits at the same time, it would be incapable of returning such deposits. Or, for example, where, due to a worsened financial situation of A, a bank starts receiving no or lower than the envisaged interest on a loan it has concluded with A, it will pay a lower rate of interest under an interest rate swap which it has entered into with B (whilst B will continue to pay the defined fixed interest). The problem in the loan will be «felt» in the interest rate swap («attaching» itself to the destiny of the loan was, in fact, even the idea of the swap – a hedge of the loan). In addition, 55

35 On globalisation of financial markets – SCOTT, 3 and 4.

36 SCHNYDER, Conflicts of Law, 426.

37 On the trend towards harmonisation of the regulation of international finance – SCOTT.

38 The definite article «the» is used here in order to illustrate more clearly the connection, but the money deposited by depositors is not the same money as that which the bank lends to the borrowers – depositors deposit value (which they have the right to receive back) rather than physical banknotes, coins or electronic book entries.

financial transactions interrelate with other branches of the economy – construction, manufacturing etc. – since they ensure the financing for the operation of those. Furthermore, as mentioned, globalisation has had a great impact on financial transactions. It has caused them to be concluded more and more on a cross-border basis, which has led to a financial transaction evolving on the market of one country being able to affect a financial or namely non-financial economic transaction taking place on the market of another country.

V. Public interest

56 Public interests (or general interests) can be both the interests of the public as a whole or the interests of one segment of the public, whereby this segment is deemed to deserve the same protection as the whole public. Public interests usually rank higher than private interests, which is why a transaction threatening them might be invalid, even if the parties to it have an interest in seeing it executed. Habitually, the state perceives public interests as its own interests, i.e. it «declares» them the state's interests.

57 Financial transactions often touch upon public interests. That is so, on the one hand, due to the aforementioned systemic nature. On the other hand, a large number of people are involved. Many rules regulating this business have proven themselves necessary due to this numerousness. For instance, some relations that were *ab initio* pure corporate relations had to be regulated by financial markets law because of this numerousness. Even if the author gave it for other purposes[39], one can use LEHMANN's example of German rules imposing a particular conduct on the board of a company in case of a takeover – §§ 27, 33 to 33c German Securities Acquisition and Takeover Act[40]: where the shares of a company are not traded on the financial market, the relation between the board and the shareholders at the time of a takeover is subject matter of company law but, where they are publicly traded, this relationship starts needing to be addressed by financial markets law rules as well.

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[39] – in order to demonstrate one area of overlap of the (otherwise separate) international financial markets private law and international corporate law.

[40] LEHMANN, 565.

VI. The law of financial transactions

The law of financial transactions, i.e. the law that governs the latter, is financial markets law[41]. This is a mixed and complex branch of law. Financial transactions are creatures of private law, in particular of contract law, but, since some of their aspects can have an impact on public interests, public law also steps in. Private law governs the financial transaction as a contract, whilst public law sets frames to the private law freedom of contracting. A single action can be counteracted through an administrative measure of withdrawal of a licence, a criminal-law-originated fine and a civil law claim for recovery of damages.[42] 58

VII. The law of international financial transactions

Financial transactions with international elements are regulated by international financial markets law[43]. This is a separate area of law with its own problems, method and approach «distinctive to it, though not necessarily exclusive 59

[41] When addressing the law regulating financial transactions, the English legal literature uses (as if they are synonyms) terms which do not refer to «market» or «markets» – «financial law» or «finance law» – as well as a term which refers to «market» or «markets» – «financial markets law». The German literature uses «financial markets law» («Finanzmarktrecht») more often than «financial law» or «finance law» («Finanzrecht»). «Financial markets law» is more appropriate here because it excludes public financial law (or public finance law), which is a branch of law not dealt with here – the one that comprises tax law, law on state budget and other rules related to public finances.

[42] LEHMANN, 174ff.

[43] Analogically to the case with «financial law» or «finance law» and «financial markets law», the English literature uses both the synonyms «international financial law» and «international finance law» and the term «international financial markets law», whereas the legal literature of the German-speaking countries refers to «international financial markets law» («internationales Finanzmarktrecht») rather than «international financial law» or «international finance law» (the latter two translated as «internationales Finanzrecht»). That is why an analogical term will be used for the international context of the problem: «international financial markets law» (as above; it is more precise inasmuch as it excludes a subject matter which is namely out of the scope of the current analysis – here international public financial

to it». At the same time, however, it is not necessarily «separate and independent of local systems of law»[44].

60 International financial markets law is mostly conflict law. The rest is a material law substrate (e.g. international standards) and it is not small in quantity but is weak in legal force. International financial markets law, in its conflict as well as in its material law part, contains both public law and private law.

61 Finance being part of the economy, international financial markets law is a part of international economic law. *Ergo*, some problems of the latter might be topical for international financial markets law, e.g. the putting into question of the operation of the traditional methods of international economic conflict law due to the interconnectedness of national economies[45]. However, some problems of international economic law are further intensified in international financial markets law owing to the specificities of the latter. For instance, the use of the traditional conflict of laws rules is even more difficult than in other branches of international economic law. The criteria of these rules (e.g. the place of the physical delivery of goods) are too tangible, too traditional, too national. To start with, financial business' «products» – rights, financial risks, etc. – are often not in a physical form and thus hardly assignable to a physical territory[46]. Then, the inventive financial industry steadily engineers complicated products which hardly fit traditional legal structures that might otherwise serve as criteria for connecting. Next, non-traditional conflict of laws rules – those legitimising the application or consideration of overriding mandatory rules – need to be applied more often than in other economic fields, as finance frequently touches upon public interests. Furthermore, the determination of (both traditional and extraordinary) conflict of laws connections is made

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law or international public finance law containing e.g. international tax law or law on the budget of international organisations).

44 SEBASTIANUTTI, International financial law, 64.

45 «... the classical connecting elements (territorial or personal) appear more and more accidental on account of the interdependence of national economies and the increasing mobility of the respective actors», which leads to a need for «the co-ordination of competencies and the supervising instruments». (SCHNYDER, Conflicts of Law, 429, 426 respectively).

46 See also SEBASTIANUTTI, International financial law, Part 2, 162.

harder by the (not merely cross-border but) multi-border character of financial transactions[47]. The acts through which the latter are executed and their legal and economic effects might take place in various countries at the same time[48].

Subchapter 2: International arbitration in finance

I. Background

1. Reluctance towards international arbitration before

In the past, there was not much international arbitration in the financial sector as there has always been in the real economy – some state that there was more than is generally thought, but it is a fact that not many of the published international arbitration awards or state court judgements connected to international arbitrations dealt with financial contracts. That might be explained by the young «age» of many of the types of financial contracts, which means that no need has yet unfolded to discover all available dispute resolution techniques. The reasons most frequently spoken of to explain it are, however: that the disputes which arose in finance, especially those originating in banking, 62

[47] In SEBASTIANUTTI's view (SEBASTIANUTTI, International financial law, Part 2, 160) they are «intrinsically multi-jurisdictional». The term «multi-jurisdictional» probably refers to both – many adjudicators and many laws – for «jurisdictional» seems to be used in its wide meaning as referring to a legal system, and not in its narrow meaning as characterising only competence to adjudicate.

[48] On the example of banking, according to the ICSID arbitral panel in *Deutsche Bank v Sri Lanka*, «the reality of today's banking business is that major banks operate all over the world. The fact that one subsidiary or branch does the paperwork does not mean that the financial instrument is located in the country concerned».
SEBASTIANUTTI, International financial law, Part 5, 468, 469 gives the example of an international bond which is issued out of London by a Hungarian corporate specialising in alternative energy and guaranteed by its Italian parent company, with dealers or underwriters from the US, Japan, Germany, Korea, Australia and China and potential investors not only from the countries of the involved actors but also from the Near East, Canada and Brazil. (For SEBASTIANUTTI, the public law norms of the place of the issue (UK), of the issuer (Hungary), «perhaps» of the guarantor (Italy), potentially of the dealers and underwriters and of the placement and selling will be relevant.).

were considered as not demanding special knowledge (such as that of an expert that one could appoint as an arbitrator) since they involved simple legal issues, e.g. whether the borrower had paid or not; that the state courts of bank-friendly jurisdictions could be chosen; or that banks were not motivated to seek a quick dispute settlement of the type that international arbitration could offer because they would be satisfied with the interest rates and they would possess collateral securities[49].

63 Thus, the Loan Market Association's model clauses, for example, referred to state courts, and so did the ISDA Master Agreement whose jurisdiction clause was in favour of New York or London state courts. Some of the few submissions by the financial industry to international arbitration represented unilateral optional clauses (which apparently did not establish a firm competence and were anyway at risk of being deemed invalid in some countries). Only particular types of financial transactions, such as reinsurance dealings or loans granted by multilateral financial institutions (e.g. the World Bank, regional development banks), were entrusted to international arbitrators.

2. Increasing interest nowadays[50]

2.1 Trend

64 The reluctance of the financial industry to refer its cases to international arbitration is being overcome. Representatives of arbitral institutions confirm a rise since the financial crisis in their finance-related work[51]; options for international arbitration have been added to model agreements used in the sector, such as the ISDA Master Agreement[52]. The arbitration community has even started preparing itself for financial markets law disputes. It has undertaken changes tailored precisely to the new «clientele» – for instance, in 2012 a new arbitral institution specialised in financial disputes, P.R.I.M.E. Finance, was established in The Hague, the Netherlands. It has also made changes of

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[49] Further on the reasons for the financial sector's unwillingness to arbitrate: SHEPPARD.

[50] See, *inter alia*, HANEFELD, Arbitration in Banking and Finance, PETERSON and MISTELIS.

[51] See *Rapport Final*, 97.

[52] More on the adoption of the clauses: in PEACOCK/KENNELLY/BLANSHARD.

general application but especially useful for financial disputes – e.g. rules on joinder and consolidation, international arbitrators' powers to impose provisional measures or fast track procedures have been adopted.

2.2 Reasons[53]

What triggered the increasing recourse to international arbitration was, in the first place, the financial crisis which started in 2008[54]. It led to an overall increase in disputes in the sector which then prompted a search for new dispute resolution methods. The growth in the over-the-counter clearing also contributed to the trend because clearing houses prefer arbitration. In addition, more and more financial transactions (e.g. project financing dealings) have been concluded with parties from the emerging markets against which the usual preference is to arbitrate rather than litigate. 65

However, the financial industry would not have chosen it if it did not see certain advantages in international arbitration (and in fact in arbitration generally). Of course, as with anything, there are also pitfalls of arbitrating rather than litigating a financial markets law dispute – but these appear to be fewer than the advantages[55]. The strength that probably comes to mind first is the deciding body's expertise – this is very useful in financial disputes which are often highly complex[56]. Another factor is the very wide international recognisability and enforceability of arbitral awards ensured by the New York Con- 66

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[53] For further discussion on why international arbitration and arbitration as a whole is a suitable means for resolving disputes of the financial sector – MAZURANIC/FAVRE, WERLEN, BERGER or DRAGIEV.

[54] «The financial crisis is changing the litigation culture in the banking and financial industry.» – BERGER, foreword. Also the representatives of arbitral institutions talk about increase in work related to finance namely since the financial crisis – see *Rapport Final*, 97.

[55] See for some of the flaws DRAGIEV.

[56] A case from 2012 triggered by the bankruptcy of Lehman Brothers and concerned with interest rate swaps and forward freight agreements concluded under the ISDA Master Agreements demonstrates the complexity of issues which can arise upon interpretation of these Master Agreements – *Lomas & Ors v JFB Firth Rixson Inc & Others, [2012] EWCA Civ 419*. As a matter of fact, the state court which looked at the case here had a good understanding of derivatives, but this would not always be the case.

vention. This feature is very valuable to the financial business due to the latter's cross-border operating, and especially to its crossing borders of «emerging» markets, in which recognition and enforcement difficulties might be great. Another advantage of submitting a dispute to international arbitration is that an unambiguous jurisdiction is created. In this way, certain difficulties (such as that of defining the place of performance of an obligation) are avoided and potential attempts to «escape from» legal proceedings by questioning the appropriateness of the forum are left without prospect. Then, the contestability of the arbitral award on only few and strict grounds strengthens legal certainty. Flexibility is another advantage – parties themselves can choose the applicable procedural rules, the language in which the arbitration will be conducted and so on. Further, the proceedings are quick, albeit one should note that nowadays velocity has decreased to become not much greater than that of state court proceedings, and this concerns also the examination of financial markets law disputes[57]. An essential plus is also the neutrality; to begin with – neutrality towards the parties (international arbitrators would not favour particular types of parties – e.g. insured persons); then – neutrality in respect of legal orders (international arbitrators are not affiliated to a particular state and would not need to protect the interests of such). Neutrality is, for example, one of the reasons why financial transactions concluded with state partners in their *acta jure gestionis* (especially where those are the debtors) and with parties from emerging markets are often submitted to international arbitration. Another positive side of international arbitration is the avoidance of the conduct of legal proceedings in unfamiliar jurisdictions, which is associated with additional (legal, translation and other) costs. Last but not least, the opportunity to have the adjudication kept confidential will be appreciated by the financial industry, for which reputation (and with this, privacy) is crucial.

II. Financial transactions likely to be submitted to international arbitration

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[57] Probably this decrease in the rapidity of the proceeding was what prompted the mentioned introduction of special expedited procedures. Whether the latter would manage to solve the problem remains to be seen.

Arbitration (in general, not only international arbitration) of retail banking would be problematic. An objective law might be prohibiting arbitration with consumers, or a state court might find that the bank has «imposed» the arbitration clause through a bad faith use of its economic power over the retail client. Then, the practice in that area would often prefer state courts because it would see them as more protective towards small, inexperienced consumers. In addition, the few cases of arbitrating would be domestic arbitration, since, as already noted, consumer banking is quite a national business. Corporate banking is more likely to «seek» international arbitration, since the business appreciates arbitration as a way of dispute resolution, often operates transnationally, and is not covered by consumer protection laws that possibly exclude arbitrability. Actors of investment banking are also inclined to go to international arbitration for the same reasons as actors of corporate banking. Non-banking finance is also likely to be a «client» of international arbitration, as those who conclude financial transactions and are not banks are most often professionals viewing international arbitration as convenient. Reinsurance companies, for example, are, in fact, a traditional client of international arbitration; insurers are a rather recent one (some of their new products, e.g. warranties and indemnities insurance, refer to it).

III. Empirical evidence

Throughout a general review of case law and literature, international arbitrations were encountered in: a bank guarantee[58]; a bond subscription agreement; 68

[58] E.g. ICC arbitration case *SITI – B&T Group S.p.A. (Italy) v PAT AKB Industrialbank (Ukraine)*, *ICC arbitral tribunal, 14 June 2010, Case No. 15818/FM (unpublished)* followed by a decision on an action for annulment of the resulting award before the Court (*Case No. DSC 4A_414/2010 of 27 October 2010*) concerned payments under bank guarantees. For more information on the case, see WIETZOREK.

an investment agreement[59]; put and call option agreements[60]; project financing[61]; syndicated loans[62]; an «integration and investment agreement» between financial markets actors[63]; insurance and reinsurance[64]; a settlement agreement between a wealth manager and his client[65]; a «vulture» funds' claims[66].

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[59] – providing for a Singapore law and arbitration at the SIAC – *Transpac Capital PTE Limited v Buntoro [2008] NSWSC 671 (Supreme Court, New South Wales, 7 July 2008, No. 11373 of 2008)*.

[60] The agreements between a French and Italian party in *DSC 4A_500/2007 of 6 March 2008*; the option agreements that have led to the *Megafon case* examined in *DSC 4P.208/2004 of 14 December 2004, DSC 4P.102/2006 of 29 August 2006* and *DSC 4P.168/2006 of 19 February 2007*.

[61] One can mention the arbitration of the *Hydro dispute* regarding the size of the financing that Deutsche Bank had agreed to provide for the construction of a hydro power plant – see Deutsche Bank's Annual Report 2013 on Form 20-F (the form is to be filed with SEC by «foreign private issuers» that have listed equity shares on exchanges in the U.S.), Item 8: Financial Information, 68. The concessionaires claimed future damages resulting from the potential withdrawal of the concession for which the Albanian state might have held them liable. On the evolution towards international arbitration in the field of international project financing DUGUÉ.

[62] Reported by GILLOR, 61ff. The author describes a tendency from court jurisdiction clauses through «split jurisdiction clauses» to arbitration clauses in these transactions: the first were mostly used with counterparties from Europe; the second with parties from outside Europe, especially from emerging markets like Russia and the former Soviet states, Asian or African countries; the third are the newest trend and often come *in lieu* of the optional jurisdiction clauses.

[63] «Integration and Investment Agreement dated as of as of March 30, 2010 by and between Mitsubishi UFJ Financial Group, Inc. and Morgan Stanley» for the integration of both parties' Japan related securities businesses which in Art. VIII, Sec. 8.2 submits potential disputes to arbitration in Tokyo under the auspices of ICC – see the Mitsubishi UFJ FG Annual Report on Form 20-F for the fiscal year ended 31 March 2010, Exhibit 4(e).

[64] One case which reached (English) state courts *Sulamérica Cia Nacional De Seguros S.A. and others v Enesa Engenharia S.A [2012] EWCA Civ 638* concerned both insurance and reinsurance at the same time.

[65] – a settlement agreement regarding the dispute examined in cases *4A_80/2010 of 26 April 2010* and *4A_642/2010 of 15 February 2011*.

[66] «Vulture» funds are hedge funds or other financial vehicles which buy troubled sovereign (or corporate) bonds on the secondary market at a time when (due to the debtor's inability to

Interviews with lawyers from Swiss banks brought evidence of probably upcoming, though not yet widespread, use of international arbitration in finance. One Swiss bank reported that about sixty percent of the agreements for the distribution of its financial products outside Switzerland were subjected to (mostly Swiss) arbitration. Another Swiss bank stated that it frequently chose London arbitration for the contracts it concluded with counterparties from other European countries under the ISDA Master Agreement. A third Swiss bank, which is a part of an international banking group, resorted to arbitration when dealing in private equity with counterparties that were not Swiss or not belonging to its banking group. 69

The annual reports of the so-called global systemically important financial institutions (G-SIFIs) as determined by the Financial Stability Board – the global systemically important banks (G-SIBs) as defined by the Board in 2011, 2012, 2013, 2014 and 2015 and the global systemically important insurers (G-SIIs) as defined by the Board in 2014 and 2015)[67] – inform about arbitrations, some of which are international, on the following financial transactions or cases related to such: auction-rate securities[68], investment management[69], processing 70

pay back or due to repudiation) their price is low. They then seek (in legal proceedings) the recovery of the entire sum. «Vulture» funds resort to both international and investment arbitration.

[67] As of 04.03.2015, the Financial Stability Board is working on methodologies for defining Non-Bank Non-Insurer Global Systemically Important Financial Institutions (NBNI G-SIFIs).

[68] JP Morgan Annual Report 2010; Citigroup Annual Report 2011, 271; UBS Annual Report 2010 and UBS annual reports and 20 -F forms for the years 2011 and 2012; Bank of New York Mellon Annual Report 2011, 152; Credit Suisse Annual Report 2011, 339; Bank of America Annual Report 2012, 226.

[69] Goldman Sachs Quarterly Report for the period ended March 2015 on Form 10-Q, 95 and Goldman Sachs Annual Report 2014, 195; JP Morgan Annual Report 2011, JP Morgan Annual Report 2012.

of debit card transactions[70], mortgages[71], mortgage-backed securities[72], project financing[73], financial advisory services[74], ownership of economic exposure to Greek bonds[75], municipal bonds and closed-end funds[76], sales of Lehman principal protection notes[77], structured transactions and derivatives[78],

[70] JP Morgan Annual Report 2011, 297.

[71] Credit Suisse Financial Report Third Quarter 2015, 129 (residential mortgage loans); Goldman Sachs Quarterly Report for the period ended March 2015 on Form 10-Q, 92 and Goldman Sachs Annual Report 2014, 192 (mortgage-related products); UBS Annual Report 2012 and 20-F form 2012 filed with SEC (mortgage-related securities).

[72] The Royal Bank of Scotland plc Results for the half year ended 30 June 2014, 29.

[73] Deutsche Bank had to arbitrate a dispute over the funding of a hydro power project in Albania (in particular over the extent of its obligation to fund). The dispute was settled – see Deutsche Bank's Annual Report 2013 on Form 20-F, Item 8: Financial Information, 68.

[74] Goldman Sachs Quarterly Report for the period ended March 2015 on Form 10-Q, 95 and Goldman Sachs Annual Report 2014, 195.

[75] The Royal Bank of Scotland Holdings N.V. (RBS Holdings N.V.) Interim results for the half year ended 30 June 2015, 21; The Royal Bank of Scotland N.V. (RBS N.V.) Interim results for the half year ended 30 June 2015, 21.

[76] UBS Annual Report 2013 and UBS 2013 annual report on 20-F Form filed with SEC as well as UBS Annual Report 2014.

[77] UBS annual reports and 20-F forms filed with SEC for the years 2012 and 2013 – customers' allegations of a failure to disclose the risks upon such sales by UBS Financial Services Inc.

[78] UBS Annual Report 2012 and 20-F form 2012 filed with SEC.

insurance brokerage[79], squeeze-out price[80], exercise price of a put option[81], investment[82] and cases related to the financial crisis as a whole[83].

With regard to derivatives, it can be noted that the introduction of model arbitration clauses into the ISDA Master Agreement in 2013 was very much commented on as setting a trend towards arbitration – but it seems that this type of dispute resolution was used also prior to that, simply in a non-standardised manner[84]. 71

IV. Arbitrability[85]

Claims resulting from financial relations will be arbitrable under Art. 177 PILA because they are of a pecuniary nature. Following the logic from Chapter 72

[79] UniCredit S.p.A. Report and Accounts 2010 and UniCredit SpA Group Consolidated Reports and Accounts 2010, UniCredit SpA Reports and Accounts 2011, UniCredit SpA Group Consolidated Reports and Accounts 2011 and UniCredit SpA Reports and Accounts 2012 and UniCredit SpA Group Consolidated Reports and Accounts 2012, UniCredit SpA Reports and Accounts 2013 and UniCredit SpA Group Consolidated Reports and Accounts 2013. A settlement was reached in 2013.

[80] One of the minority shareholders of Bank Austria initiated arbitration against UniCredit regarding the squeeze-out price paid by the latter upon purchasing 99, 995 % of Bank Austria's shares – see UniCredit S.p.A. Reports and Accounts 2010, UniCredit Group Consolidated Reports and Accounts 2010.

[81] Dexia went to the International Court of Arbitration in Madrid over a dispute on the exercise price of a put option granted by Dexia Crédit Local (France) regarding the stake of Banco de Sabadell (Spain) in Dexia Sabadell (Spain) – see Dexia Annual Report 2014, 33.

[82] Citigroup faced ICDR-AAA arbitrations regarding an Abu Dhabi investment (Annual Report 2013, 306).

[83] UBS Annual Report 2012 and 20-F form 2012 filed with SEC.

[84] That is evident from the information obtained through the conducted interviews with Swiss banks' lawyers as well as from GILLOR's article dating back before the introduction by ISDA of model arbitration clauses and dealing with the use of international arbitration.

[85] Further on arbitrability, including on the influence of public interests on arbitrability, of financial transactions historically and comparatively in several jurisdictions – HANOTIAU, 36ff; briefly on arbitrability of disputes related to derivatives – MAZURANIC /FAVRE, point 4.1.

4, II., last paragraph, such arbitrability will exist also where financial overriding mandatory rules regulate the financial relations.

V. Arbitration agreement

73 Arbitration agreements submitting financial disputes to international arbitration are no different to arbitration agreements submitting any other type of disputes to international arbitration. One can only note that financial model agreements (which, due to the complexity of the business, are used often) have lately started to refer to international arbitration ever more frequently; examples are the above-mentioned famous ISDA Master Agreement[86], the European Master Agreement[87], the ISDA/IIFM Tahawwut Master Agreement[88], the Loan Market Association Facility Agreement for Pre-Export Finance Transactions[89], and other standard facility agreements of the Loan Market Association (like the Loan Market Association Development Markets Secured Document[90]).

VI. Arbitral institutions

74 International arbitration in finance can be conducted by *ad hoc* arbitral tribunals or those administered by arbitral institutions. The latter can be the traditional arbitral institutions that shelter disputes from any area, like the Swiss

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[86] In September 2013, the Association published an Arbitration Guide with model arbitration clauses as options.

[87] – the Master Agreement for Financial Transactions, sponsored by the Banking Federation of the European Union in cooperation with the European Savings Bank Group and the European Association of Cooperative Banks. Sec. 11 (2) of its 2004 edition contains a sample jurisdiction clause granting a choice between state court and arbitration and Sec. 4 of its Special Provisions, as reviewed in 2013, submits disputes to the Euro Arbitration, ICC or any other arbitration centre. (The Agreement is, however, less used in derivatives than the ISDA Master Agreement.)

[88] – with its Sec. 13 (c) providing for the possibility to submit future disputes to an ICC arbitration seated in London or New York – whilst, however, one can opt for another forum.

[89] Its Sec. 12 provides for an option to arbitrate under the LCIA.

[90] – stipulating an option for arbitration next to that for litigation in England.

Chambers' Arbitration Institution, ICC, LCIA, ICDR-AAA, HKIAC, SIAC, or arbitral institutions specialising in the financial sphere. Some of the specialised ones have been established recently as a reaction to the increase in financially related legal procedures (caused by the financial crisis). Notable are the already mentioned «P.R.I.M.E. Finance» in The Hague[91], the «Euro Arbitration – European Center for Financial Dispute Resolution» («EuroArbitration»)[92], and the City Dispute Panel in London (established in 1994), which *de jure* (according to its rules and model clauses) is not specialised in financial matters but *de facto* is most popular for financial transactions and interbank settlements. There is a discussion whether to create a sovereign non-investment debt arbitral tribunal – one that deals with sovereign debts (e.g. state bonds) and in particular with the restructuring of such debts. Currently creditors of the latter lodge their claims either with a national court (in their capacity as creditors) or with an investment arbitration (relying on their investors' qualification[93]). Some authors advocate for the tribunal[94], whilst others oppose it[95]. In any case, the real challenges in the area would not be resolved, for those are of a substantive character – e.g. the lack of globally recognised international public insolvency law[96].

Subchapter 3: Other arbitrations in finance

Described here below in this Subchapter 3 are other arbitrations in finance – other than international arbitration in finance. The latter is the arbitration in finance which is taken as an example here, whilst these other arbitrations in finance will remain outside the scope of the current analysis (and are mentioned solely for completeness). 75

91 More on P.R.I.M.E. Finance: DALHUISEN, P.R.I.M.E.; ROSS; PEACOCK/KENNELLY/BLANSHARD.

92 – existing since 2000 and administering disputes between professionals concerning financial instruments, asset management, clearing, settlement and other financial matters. On Euro-Arbitration: HIRSCH.

93 An example here is *Abaclat v Argentina*.

94 PAULUS, 320 f. contending that the World Bank Group is «a source of perceived bias».

95 HANEFELD, Sovereign Debt Tribunal.

96 HANEFELD, Sovereign Debt Tribunal.

I. Domestic arbitration in finance

1. Voluntary domestic arbitration in finance

76 Voluntary domestic arbitration in finance, which is always commercial (never public law) arbitration, is domestic arbitration that is not imposed on any of the parties. For instance, in the US case *LRN Holding, Inc. v Windlake Capital Advisors, LLC, 949 N.E. 264 (Ill.App.3d 2011)* a contract for brokerage services was subjected to domestic arbitration (the state court whose judgment is cited here was seized at first and it compelled arbitration)[97].

2. Mandatory domestic arbitration in finance

77 Mandatory domestic arbitration in finance is that domestic arbitration which must be agreed on in order that one is allowed to conduct certain financial business. It usually takes place before an arbitration institution established especially for accomplishing it. It can be commercial mandatory domestic financial arbitration (when the dispute is between private law parties) and public law mandatory domestic financial arbitration (where one of the parties exercises public law powers over the other). Unlike international arbitration in finance, mandatory domestic arbitration in finance is not a new phenomenon.

2.1 Mandatory domestic arbitration in finance imposed by a self-regulatory organisation

78 The disputes resolved in a mandatory domestic arbitration in finance which is imposed by a self-regulatory organisation (SRO, in plural – SROs) are mostly: those between a member of the SRO and the SRO in relation to the exercise by the latter of public law powers (delegated to it by law) over the former; those between one member of the SRO and another member of the SRO; and those between a member of the SRO and a client of such member. The arbitral

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[97] This dispute is also an example of the relevance of financial overriding mandatory rules in domestic commercial arbitration in finance, as the brokerage services contract in question was claimed to be void (and fees paid under it to be reimbursable) since the broker failed to meet a rule that could be qualified as a financial overriding mandatory rule – one that required the broker to register its services under the Illinois Business Brokers Act of 1995.

institution is mostly embedded in the SRO. Stock exchanges, such as the SIX, are a common example of SROs that impose arbitration in finance (the so-called stock exchange arbitration).. Another example of SROs that impose arbitration in finance are industry associations, membership of which is a precondition for the execution of certain business. Such associations might require consent to arbitration in order to grant such membership. One can mention the Financial Industry Regulatory Authority (FINRA) in the US.

2.2 Mandatory domestic arbitration in finance imposed by a financial regulator

In France, the Financial Markets Authority has competence deriving from Art. 516–16 of the French General Regulation of the Financial Markets Authority to start arbitration for resolving disputes between a stock exchange and one of its members, among stock exchange members or between a stock exchange member and its customer. However, this is not much used in practice. It resembles stock exchange arbitration, with the difference that here the procedure is imposed and started by the state regulator instead of being imposed by the stock exchange and initiated by a party to the dispute. Then, one can mention the Financial Dispute Resolution Centre in Hong Kong, which has operated since 2012 as a permanent mediation and arbitration organisation for disputes between financial institutions and their clients who are physical persons or one-person companies. Participation in the arbitration is mandatory for the financial institutions registered or authorised by the Monetary Authority or the Securities and Futures Commission of Hong Kong (with some exceptions) and is optional for these financial institutions' customers. 79

II. Investment arbitration in finance

80 Until recently, investment arbitration has dealt prevailingly with claims of the real economy. However, ever since the famous *Abaclat v Argentina* and *Deutsche Bank v Sri Lanka* proved that financial undertakings qualified as investments, more and more financial disputes have been brought; this is also because global

financial turmoil and the debt crises in some regions of the world have generated occasions for complaints.[98]

[98] For instance, currently (24.02.2019) a case *Cyprus Popular Bank Public Co. Ltd. v Hellenic Republic* is pending before an ICSID panel (*ICSID Case No. ARB/14/16*). The claimant contends that during the Greek crisis in 2012 it was treated less favourably than other banking institutions in Greece.

Part 2: Applicable law

Chapter 6: The term «applicable law»

I. «Applicable»

Through the word «applicable» in the term «applicable law», the international arbitration legal practice and doctrine refer most often to a law's competence to regulate which originates in the traditional private international law's conflict of laws rules, i.e. a principal competence to regulate. Understood in this way, the word «applicable» caters for a meaning of the expression «applicable law» as «proper law», «*lex causae*» or, in the language of PILA[99], «designated» law». Except those of them which belong to a *lex causae* that is connected to uniformly, overriding mandatory rules remain outside the scope of such applicable law – their competence to regulate does not derive from the traditional private international law's conflict of laws rules[100] and it is, thus, an exceptional rather than a principal competence to regulate. 81

This meaning of «applicable» used by the international arbitration practice and literature is not the literal meaning of the word. It is more technical than the literal meaning. More precisely, it is specific to private international law (in particular to one of the main tasks of private international law – to appoint one out of many legal systems to regulate an international relationship between coequals[101]). The literal meaning is more general – it makes sense also in other branches of law apart from private international law – e.g. there would be «applicable» national private law or «applicable» international public law. Besides, the literal sense refers to both principal and exceptional competence to 82

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99 – e.g. Art. 19 PILA talks about law «designated by this Act».

100 – but, depending on the theory followed: from special conflict of laws rules of private international law, from special autonomous conflict of laws rules or from them (overriding mandatory rules) themselves, in particular from their own substantive high importance.

101 It is probably because «applicable» law is the subject matter of one of the main tasks of (and thus of great importance for) private international law that the latter's understanding of the term is encountered most frequently.

regulate: the semantics points at the presence simply of competence i.e. of any competence to regulate.

83 In fact, the title of Sec. 3 of Chapter 1 PILA – «Applicable law» – appears to use the term «applicable» in its literal meaning and hence to encompass both principal and exceptional competence to regulate. Evidence is that the section itself contains not only rules on *lex causae* – Art. 13, 14, 15, 16 and 17 PILA – but also such on overriding mandatory rules – Art. 13[102], 18 and 19 PILA.

84 In order to be consonant with the legal practice and the remaining literature and also to have two separate terms signifying «proper law» and «overriding mandatory rules» for the purpose of comparing these two in a clearer way, the current work will use the first-mentioned, narrow meaning of «applicable» which renders «applicable law» a synonym of «proper law», «*lex causae*» or «designated law». Only sometimes (and whilst expressly noting this) will the wide sense of the term be resorted to.

II. «Law»

85 Strictly speaking, naming Art. 187 PILA «Applicable *law*» (own emphasis) and using this term as well as its (academic-flavoured) synonym «*lex causae*» in order to signify what the mentioned article regulates is incorrect because the latter does not prescribe only applicable «law» but also applicable «non-law»: the *ex aequo et bono* considerations envisaged in the second paragraph represent namely non-law – they are rules of social systems other than law. If wishing to cover all the causās made available by Art. 187 PILA for the substantive resolution of the international arbitration dispute, one should rather speak of «applicable norms», «applicable law and concepts» or simply of «*causa*». However, for the sake of consistency with the literature's language and since anyway solely legal norms are relevant to the present topic (overriding mandatory rules constitute legal norms), the terms «applicable law» and «*lex causae*» will be used here as if they encompass all the causās under Art. 187 PILA – legal *causa* and non-legal *causa*.

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[102] Art. 13 PILA deals simultaneously with *lex causae* and overriding mandatory rules.

Chapter 7: Determination of applicable law

I. Method

It is private international law, in particular that of the *lex arbitri*, that defines the law to be applied to the substance of a dispute, including a financial dispute, which undergoes international arbitration. The method it uses was established by Savigny and consists of conflict of laws rules formulated in an ««abstract» manner»[103] and using as a criterion the facts of the case without considering the content of the rival laws (i.e. the respective law becomes applicable «from the facts»[104]; the concrete (subjective) relationship plays a central role). 86

II. Conflict of laws rules

1. The references

The Swiss *lex arbitri* provides the conflict of laws rules on applicable law in international arbitration in Art. 187 PILA. 87

This rule stipulates that a dispute is resolved *ex aequo et bono* when the parties have authorised the international arbitrator to do so (Art. 187 (2) PILA) [105], 88

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[103] SCHNYDER, Wirtschaftskollisionsrecht, 56, *in initio*.

[104] However, this underlying of the extraction of a law's applicability from the facts of a case might be confusing because the facts play a role for the applicability of any law, not only for the applicability of a law referred to by a private international law's conflict of laws rule – in order that the dispositive order of a law applies to the facts of any case, the latter must qualify under the hypothesis of such law, and in this sense any law is connected to according to the facts of the case. The peculiarity of private international law is rather that the extraction of the applicability of a law from the facts of a case is not followed by a check of the content of the law whose applicability these facts point at.

[105] Similarly does Art. 28 (3) UNCITRAL Arbitration Model Law, § 1051 (3) German Code Of Civil Procedure, Sec. 46 (1) (b) English Arbitration Act 1996 (referring to «such other considerations as are agreed by them [the parties] or determined by the tribunal»), Art. 31 (3) ICDR-AAA Rules, Art. 21 (3) ICC Rules, Art. 33 (2) Swiss Rules.

according to the law chosen by the parties[106] (Art. 187 (1), first suggestion) or in the absence of such a choice according to the law (German and Italian translation of PILA) respectively rules of law (PILA's French version) most closely connected to the case (Art. 187 (1), second suggestion PILA). The *ex aequo et bono* adjudication is here mentioned first, even if Art. 187 PILA provides for it after the other two connections (in the second paragraph) and even if the literature usually follows this order of the article, because a first place corresponds more to the subsidiarity in the connections since, in fact, if *ex aequo et bono* authorising is present the other two connections will not be resorted to.

89 The *ex aequo et bono* adjudication and the application of the law chosen by the parties are known as subjective connections since they are based on the will of the parties whilst the application of the law most closely connected to the case is an objective connection – the closeness of the facts of the case to the respective law does not (at least directly[107]) depend on the parties' will.

90 It is evident that the will of the parties (or the subjective type of connection) is a priority – if the latter have agreed on arbitration *ex aequo et bono* or on a law to be applied, the arbitrator will have to follow such agreement, without being able to construct the objective connection[108].

91 As a side note of comparison, in the EU, conflict of law rules on the law applicable in international arbitration are contained in some acts on specific types

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[106] Other examples of conflict of laws rules conferring a choice of law include Art. 3 (1) Rome I, Art. 46 (1) (a) English Arbitration Act 1996, § 1051 (1) German Code of Civil Procedure, Art. 28 (1) UNICITRAL Model Law, Art. 2 (1) Hague Principles on Choice of Law, Art. 33 (1) Swiss Rules, Art. 21 (1) ICC Rules, Art. 22 (3) LCIA Rules, Art. 31 (1) ICDR-AAA and Art. 35 (1) UNCITRAL Arbitration Rules (GIRSBERGER/VOSER/COLACINO/DONCHI, 1346ff.).

[107] The parties might have the opportunity to exert influence on such connection indirectly by arranging the facts of the case which constitute criteria for such connection to take place in the country whose law they wish to see connected.

[108] Also in the determination of applicable law in state court proceedings, the will of the parties has precedence – Art. 116 PILA (parties have, however, less power than in international arbitration to appoint non-legal concepts as applicable – they cannot choose adjudication *ex aequo et bono*).

of international private law relations and whether they are contained also in the EU general private international law on contractual obligations in civil and commercial matters – Rome I and Rome Convention[109] – is disputable. In the latter discussion, the majority of authors give a negative answer[110] and a minority give a positive one[111]. Upon a strict interpretation of Rome I's text, one can defend the latter opinion. Art. 1 (2) (e) Rome I exempts from the regulation's scope only «arbitration agreements»[112], i.e. not arbitration in general – hence the determination of the law to apply to other (than the arbitration agreement) aspects of arbitration such as the substance of the case must remain within the scope of Rome I[113]. In fact, if this exclusion of «arbitration agreements» is read as an exclusion of arbitration as a whole, then (by analogy) also the exclusion contained in the same provision of «agreements on the choice of court» would have to be read as an exclusion of the whole state court procedure where the parties have chosen the court, which would be odd, since a huge amount of litigation would be excluded, keeping in mind that in civil and commercial matters – the subject matter of Rome I – choice of court is frequent. In addition, Art. 9 (2) Rome I is compatible with international arbitration; more

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[109] Rome I replaces the Rome Convention. However, since Rome I is not applicable to all EU Member States (e.g. Denmark is not bound by it because of an opt-out of regulations under the area of freedom, security and justice), the Rome Convention is still in force with regard to the Member States to which Rome I does not apply.

[110] – e.g. the following authors cited in: GIRSBERGER/VOSER/COLACINO/DONCHI, 1349, in particular fn. 1510.

[111] as cited in GIRSBERGER/VOSER/COLACINO/DONCHI, 1349, in particular fn. 1512. KARRER, BSK IPRG, Art. 187 N 259 considers the predecessor of Rome I which equally excludes arbitration agreements form its scope – Rome Convention – as applicable to arbitration.

[112] In this sense also YÜKSEL, 153 who compares Rome I with Brussels I: the former regulation excluded «arbitration agreements», and the latter – «arbitration».

[113] See YÜKSEL, 177. According to the second para of «Conclusion», not only the law applicable to the arbitration agreement but also that applicable to the arbitration procedure was excluded from the scope of Rome I. However, the law applicable to the substance of the case was not excluded and that is the point made here. On the other hand, admittedly, as underlined in the third para of «Conclusion», the regulation uses mostly the word «courts» and it is not certain whether the other encountered term «tribunals» encompasses (also) arbitral tribunals.

precisely, it does not lead to a (from the perspective of the latter «undeserved»[114]) privilege of the overriding mandatory rules of the seat of the international arbitration, because it only allows this seat to anchor, but it does not itself impose, such privilege – «Nothing … shall restrict» (most probably the seat will indeed anchor such privilege for state court proceedings, but it will not for international arbitration – and this wording of Art. 9 (2) Rome I has perhaps been adopted precisely in order to make that possible). On the other hand, the possibility remains that the EU legislator indeed intended to exclude arbitration as a whole, not only arbitration agreements, but did not express that precisely enough.

1.1 Ex aequo et bono

92 Adjudication *ex aequo et bono* is not a version of the choice of law under Art. 187 (1) PILA, first proposition, as KARRER contends[115], because parties' authorisation for such adjudging is a choice of non-legal considerations, not of law: the *ex aequo et bono* decision is based on «considerations of fairness, not of existing law»[116].

93 For now, financial actors, especially banks, are not keen on having their disputes decided *ex aequo et bono.* Their reason is consideration of legal certainty. The *Rapport Final*, 83 gives an example on how a bank's interests can be «harmed» by a decision *ex aequo et bono*: if a party fails to pay under a loan which it had taken in relation to a purchase contract because, due to a *force majeure* circumstance, its counterparty under such a purchase contract has failed to pay to it, an arbitrator might excuse the party out of a sense of equity, thus considering a *force majeure* that has «happened» outside the loan relationship (in the purchase contract); since prudential capital requirements will have demanded this, the bank will have built reserves corresponding to the credit concerned and will now not receive returns on the latter, meaning that it will have blocked financial means that could have been invested in other undertakings.

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[114] Why «undeserved» will be discussed in Chapter 23, II., 2.3 (mostly in a. thereof).

[115] KARRER, BSK IPRG, Art. 187 N 291.

[116] GIRSBERGER/VOSER/COLACINO/DONCHI, 1426.

1.2 Choice of law

The opportunity to choose a law is frequently used in international arbitration. Parties which make the «effort» to determine the forum (international arbitration) usually also make the «effort» to define the governing law. They, especially those acting in the financial sector, seek legal certainty and are, moreover, supported by sophisticated advisers. 94

1.3 The law most closely connected to the case

A difficulty, but on the other hand maybe an advantage, in international arbitration is that there is no concretisation of the concept of the closest connection as there is for state court proceedings (e.g. in Art. 117 (2) and (3) PILA, 118 et seqq. PILA). In principle, important criteria for finding the law mostly related to a transaction are the place of business or habitual residence of the parties (particularly of the one performing the characteristic obligation) or the place of performance of the characteristic obligation. When it comes to financial transactions, the place of the market often deserves to be reckoned as the one to which the transaction relates the most. 95

If the arbitrated matter reveals equal closeness to more than one laws, all of these laws can be applied – each to the relevant part with which it has this close connection. 96

In international arbitration (but also in litigation) the objective connection is associated with circumvention of law much less than the subjective one, as the usual suspects for attempting such circumvention – the parties – cannot directly[117] influence this connection. 97

2. Scope of the references

It is established in the literature that the reference in the international arbitration legislation to applicable law includes only the substantive norms of such 98

[117] They might do it indirectly – they could have the chance to cause some or all facts of the case to take place in a country other than the country whose law they wish to evade.

law without its conflict of law rules – no *renvoi*. Many choice of law clauses themselves talk about «substantive» law.

99 By selecting a law, the parties displace both *ius dispositivum* and *ius cogens* of the law otherwise applicable with the exception of one category of *ius cogens* – overriding mandatory rules. If only *ius dispositivum* was replaced, that would have been the so-called «materialised choice of law» which is, in fact, no choice of law because the thus substituted *ius dispositivum* could have been derogated from also without choosing another law – through the parties agreeing in their contract on something other than that which such dispositive rules envisaged.

100 One of the biggest disputes in connection with the scope of the reference to applicable law is connected again to Art. 187 (1) PILA[118] and overriding mandatory rules, but this time it concerns both references under that article (not only the reference to the law chosen by the parties) – namely whether these two references cover the *lex causae*'s overriding mandatory rules. This problem will be discussed below when dealing with overriding mandatory rules.

3. Types of applicable laws under Art. 187 (1) PILA

3.1 Under the current Art. 187 (1) PILA

101 At the moment there is a lack of clarity with regard to the type of applicable law referred to by Art. 187 (1) PILA. The text of the latter does not clarify whether such law can be both national and non-national or only national. The German and Italian translations refer to «law» («Recht» respectively «diritto»), whereas the French one refers to «rules of law» («règles de droit»). «Law», which is the traditional and more frequently encountered concept, is considered to be the rules in force in a particular state (national law), and «rules of law» – both the rules of a state (national law) and rules whose author is not a state (non-national law).

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[118] The issue cannot arise for the reference under Art. 187 (2) PILA because the latter can only include non-legal norms, and overriding mandatory rules are legal norms.

There is an international trend that also non-national legal orders are applied to relationships subject to international arbitration, and parties often select such orders[119]. Art. 3 of The Hague Principles on Choice of Law expressly provides: «The law chosen by the parties may be rules of law that are generally accepted on an international, supranational or regional level as a neutral and balanced set of rules, unless the law of the forum provides otherwise.». At the same time, recommendations to choose a concrete national substantive law can often be «heard» – the consideration is that the content of non-national laws is difficult to establish, also due to diverging interpretations[120].

a Non-national rules of law

Since this is the less traditional concept, it is appropriate here to make some remarks on non-national rules of law. These can be general principles of law, internationally recognised principles, or *lex mercatoria*, transnational law, a combination of national laws (rules common to two or more national laws), legal principles common to the legislations of civilised countries, etc. 103

To take the example of *lex mercatoria*, that legal system consists of «rules of transnational law developed by the international business community to regulate commercial activities within that community. The rules of the *lex mercatoria* are founded on usages developed in international trade, standard clauses or contracts proposed by international organisations, uniform laws, general principles of law and international instruments»[121]. Considering that some of them can be *pacta sunt servanda*, *clausula rebus stantibus* or *force majeure*, 104

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[119] – that is stated also in Sec. I.18 of the Introduction to The Hague Principles on Choice of Law.

[120] The danger of choosing e.g. a combination of national laws, «general principles of law», «internationally recognized principles» or «legal principles common to the legislations of civilized countries» is referred to in MEIJER/HANSEN, 6.47. Therein also, Born is cited (see reference there) as stating that these solutions can «give rise to significant questions of validity and enforcement».

[121] GIRSBERGER /VOSER /COLACINO /DONCHI, 1364. See also BANTEKAS, 47.

these rules are not firmly established and only open-end catalogues[122] are possible. BANTEKAS points at Art. 28 (4) of the UNICITRAL Model Law as an example of an obligation imposed on an international arbitrator to take into account *lex mercatoria*, in particular trade usages[123]. SEBASTIANUTTI, however, disagrees with the existence of *lex mercatoria* for international financial transactions[124]. In his view, these transactions are still subject to national laws[125] – through their behaviour, financial markets participants are only handling the implications of the multi-jurisdictional environment in which they do business but are not creating an international financial law that is «an isolated legal island unto itself, freed of legal context»[126]. One can agree with SEBASTIANUTTI.

3.2 Expected amendment of Art. 187 (1) PILA

105 The bill with amendments in PILA's Chapter 12 released in October 2018[127] includes a proposal for changing the word «law» in the German and Italian texts of Art. 187 (1) PILA to «rules of law». Such modification would be a right step. On the one side, it would remove the difference between the different language versions of PILA, which is apparently beneficial, and, on the other side, it would bring the latter in harmony with the international trend of expanding the circle of substantive norms that can be given effect to in international arbitration, in particular of allowing that also rules originating from non-national legal systems are given effect to.

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122 – like the open-end catalogue of *lex mercatoria* norms encountered in the international arbitration practice, available at (last visited on 05.02.2019): http://trans-lex.org/principles.

123 BANTEKAS, 47. As also the author points out, that rule requires that the international arbitrator takes into account trade usages even «regardless of the parties' choice of law». Art. 28 (4) talks about such taking into account «in all cases» which, interpreted systematically with the preceding rules in Art. 28, one of which contains namely this hypothesis (Art. 28 (1)), must include the hypothesis of a parties' choice of law.

124 SEBASTIANUTTI, International financial law, Part 4, 363.

125 SEBASTIANUTTI, International financial law, Part 2, 161.

126 SEBASTIANUTTI, International financial law, Part 4, 363.

127 Bundesgesetz über das Internationale Privatrecht (IPRG), Änderung vom …, Entwurf, 2018-1229, BBI 2018, 7213ff.

Part 3: Overriding mandatory rules

Subpart 1: Concept

Chapter 8: Context

I. Freedom of contract and its limitation

The freedom of contract is a general principle of private law. Yet it is not absolute. In some cases, it is limited for the sake of protecting particular interests – individual interests (e.g. the interests of the weaker party to a contract) or public interests (public health, stability of the financial system, etc.). 106

1. Legal rules and concepts for the granting of freedom of contract

1.1 Contracting as one wishes to

The freedom to contract is in the first place realised through permitting private parties to contract as they wish to, where no rule exists. 107

1.2 Dispositive rules

In addition, the freedom to contract is expressed in permitting contracting parties to deviate from dispositive rules (dispositional rules, discretionary rules, non-mandatory rules, *ius dispositivum*). Contractors may agree on something else than that prescribed by the dispositive rule, and in that case the latter would not apply[128]. 108

Dispositive norms can be encountered in both private and public law acts but more often in the former. 109

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[128] Sec. 4 (1) and (2) of the English Arbitration Act 1996 read together and separately give an express definition of mandatory and non-mandatory rules. In fact, those will be procedural rules because, arbitration being the subject matter of the Act, they will be rules of arbitration law and the latter is a procedural law, but it is worth mentioning this legislative description of a mandatory and non-mandatory norm. With regard to non-mandatory rules, Sec. 4 (2) of the Act states: «The other provisions of this Part (the "non-mandatory provisions") allow the parties to make their own arrangements by agreement but provide rules which apply in the absence of such agreement».

Dispositive rules are enacted, even though they can be derogated from, because they ensure legal certainty in the cases where the parties did not agree anything and a dispute arises.

111 The fact they are applicable only in the absence of a parties' arrangement as well as the fact that (as will be seen below) they are the antipode of «*mandatory* rules» does not mean that dispositive norms are not compulsory. When their hypothesis is realised, they are compulsory – but this realisation is present solely when they have not been derogated from by the parties.

2. Legal rules and concepts for limiting the freedom of contract

2.1 Mandatory rules

112 Opposed to dispositive rules are mandatory rules (imperative rules, *ius cogens*[129]). The latter apply even if the parties have agreed something else[130], and this is exactly contrary to how dispositive rules function. Mandatory rules act in this way because they protect important interests. Both public and private law can be the source of these rules, but more frequently it is the former.

2.2 Ordre public (public order, public policy)

113 *Ordre public* (public order, public policy) is a concept which puts together the highest (apparently public) interests in a legal system – elements which are a *conditio sine qua non* for the very existence of that system. *Ordre public* is

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[129] – not in the sense of international public law; a sense which comprises only a part of the *ius cogens* meant here – the most important ones.

[130] In its first para, the above-mentioned Sec. 4 of the English Arbitration Act 1996 provides with regard to mandatory rules «The mandatory provisions of this Part are listed in Schedule 1 and have effect notwithstanding any agreement to the contrary.». In fact, through this Sec. 4, the English Arbitration Act 1996 becomes a rare example of a *lex arbitri* providing expressly how its mandatory provisions can be identified (HENDERSON, 35, 36).

composed of both rules contained in the objective law (which will be internationally mandatory rules) and legal principles not incorporated in the objective law.

Ordre public differs from mandatory rules because its subject matter is always only public interests of the highest importance, whilst mandatory rules protect both – individual and public – interests. It is true that also one type of mandatory rules – overriding mandatory rules – will protect solely public interests, but the latter will not always (only sometimes) be so important as to be considered also a part of the *ordre public*[131]. Then (as is clear from the definition provided in the previous paragraph), *ordre public* does not need to be incorporated in the objective law, whereas mandatory rules do – they are namely rules of law. 114

II. Mandatory rules in particular

1. Types

Mandatory rules can be internally mandatory rules (ordinary mandatory rules), internationally mandatory rules (overriding mandatory rules, qualified mandatory rules, unequivocally mandatory rules) and socially (protective) mandatory rules. This Chapter 8, II., 1. uses the terms «internally mandatory rules» and «internationally mandatory rules» more often than the remainder of the current work (which refers most often to the synonyms «ordinary mandatory rules» and «overriding mandatory rules» respectively). That is because the first set of terms contains adverbs which directly oppose each other – «internally» and «internationally» – and, thus, demonstrates in a clearer manner the difference between the two types of mandatory rules concerned[132]. 115

1.1 Internally mandatory rules (ordinary mandatory rules)

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[131] More on the differentiation between *ordre public* and overriding mandatory rules in Chapter 11, IV.

[132] Also, VOSER, Lois d'application immédiate, 164 uses the adverb «internationally» (own translation from German) in order to better show the distinction.

The mandatory character of internally mandatory rules, as with the validity of ordinary law, is effective only on the territory of the state whose legislator issues them. This means that they are obligatory only if the law to which they belong is the *lex causae*. The legal protection of the interests which are legally protected by mandatory rules is not afforded such importance as to have to be spread beyond national borders – such protection is needed only «in the opinion» of the local national, but not of the international, community[133]. Ordinary mandatory law protects individual[134] or public interests. It is substantive law which the domestic conflict law treats preferentially compared to other domestic substantive law.

1.2 Internationally mandatory rules (overriding mandatory rules, qualified mandatory rules, unequivocally mandatory rules)

117 Internationally mandatory rules are mandatory not only within the territory of the country that enacted them but also abroad (hence, «*internationally* mandatory rules»), i.e. they are applicable even if they do not belong to the *lex causae* (that is also why in the German language they are called «intervening» norms – they are able to «intervene» with the *lex causae*). The reason is that those are namely the qualified mandatory rules, i.e. those of the mandatory rules which protect the most important of the interests which mandatory rules protect: being most important, the protected interests are paramount not only within the borders of the state, like the interests protected by the other type of mandatory rules (the ordinary mandatory rules), but also internationally[135]. In other words, a substantive difference between ordinary mandatory rules and overriding mandatory rules leads to a difference in the territorial scope of their

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[133] For instance, in the Swiss international arbitration *ICC Case No. 6379 of 1990* (published in YCA, Vol. XVII, 1992, 212ff.) a Belgian mandatory law prescribing a thirty-six-month notification period and obligatory access to state courts for agreements on distribution of goods was seen as expressing local preferences and, thus, as an ordinary mandatory law not to be imposed on an Italian-law-governed contract.

[134] VOSER, Lois d'application immédiate, 275 gives an example of a mandatory rule which puts the emphasis on an individual interest with the Swiss cantonal maximums on interest rates on credits.

[135] See also MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 10 with references.

mandatoriness. Due to the global scale and interconnectedness of the businesses, mandatory rules in finance – the example taken here – will more often implement international instead of local preferences and will thus more often be overriding.

In Recital 37 of its preamble, Rome I distinguishes between «overriding mandatory provisions» and «provisions which cannot be derogated from by agreement», defining the former as a narrower category (to «be construed more restrictively»). What is meant is not their territorial scope of application (which is wider – it is international); but their material scope of application – this scope will be narrower, since fewer interests will feature significance that overcomes the borders of their own jurisdictions. 118

The applicability of an internationally mandatory rule is determined by international, and not domestic, conflict law. 119

1.3 Mandatory (socially) protective rules

Mandatory (socially) protective rules seek to safeguard the interests of a category of persons considered to be in an economically weaker position. They are contained in both private and public law. Examples are the sociopolitical norms of consumer protection law (Art. 6 (2) Rome I), employment law (Art. 8 (1) Rome I) or tenant law. 120

It is difficult to assign mandatory (socially) protective rules to ordinary or qualified mandatory law, it can even be said that they are somewhere between these two. It seems that for KAUFMANN-KOHLER/RIGOZZI, for example, they are a type of overriding mandatory rules – the authors enumerate the goals pursued by those rules among the aims of overriding mandatory rules[136]. Here it is rather believed that they are ordinary mandatory rules. First, Art. 6 (2) and 8 (1) Rome I, for example, call them rules that «cannot be derogated from», which is language usually seen in definitions of ordinary mandatory rules – the language used for describing overriding mandatory rules always adds to the impossibility of avoiding the rule also an indication that such impossibility 121

[136] KAUFMANN-KOHLER/RIGOZZI, 7.93, where «mandatory rules» is a synonym of «overriding mandatory rules», as can be inferred from the preceding paragraph (7.92).

is present, even if a foreign law is applicable (through an expression like «regardless of the law applicable to the case»). Second, mandatory (socially) protective rules do not enjoy default international mandatoriness – they are internationally mandatory only in special cases when that is ordered by a special rule such as Art. 6 (2) or 8 (1) Rome I, and not always by virtue of a general[137] rule such as Art. 9 Rome I. Third, mandatory (socially) protective rules most often reflect perceptions of a particular country to be given effect only within it – e.g. which party is weak in a contractual relation.

2. Terminology

122 The term «mandatory rules» is unfortunately inconsistently used in the legislation and doctrine. Rather than the wide interpretation used here (mandatory rules in general), it is often perceived narrowly and, what is more, it is given two different narrow meanings: first, internally (ordinary) mandatory rules; and second, internationally (overriding, unequivocally, qualified) mandatory rules.

123 The first of the two narrow meanings (ordinary mandatory rules) is frequently used in material civil law[138].

124 The area in which the second narrow meaning (overriding mandatory rules) is often used is conflict law. Examples are Art. 18 and 19 PILA: the adverb «mandatorily» and the adjective «mandatory» refer to internationally mandatory rules. Probably due to the fact that conflict law deals with international cases, the internationality of the discussed problem – a rule's mandatoriness – is taken as granted. Thus, the present work may contain citations of awards,

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[137] Such a «general» rule is, in fact, special compared to the classical Savigny's conflict of laws rules because it is a conflict of laws rule that deals with overriding mandatory rules – but here it is general in the sense that it deals with rules that are generally, i.e. always, internationally mandatory, and not with those that are internationally mandatory only for the specific occasion.

[138] MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 10 with references.

court decisions or literature which refer to «mandatory norms» but mean «internationally mandatory rules»[139].

The Rome Convention even uses «mandatory rules» in both of the narrow meanings at the same time – as internally and as internationally mandatory rules. According to the Green Paper on the conversion of the Rome Convention, 45 «the expression "mandatory provision" covers multiple realities: it designates at the same time overriding mandatory rules in the meaning of Art. 7, a concept specific to private international law, and public-policy rules of national law». (By «public-policy rules of national law» the Green Paper seems to mean ordinary mandatory rules, and not the above-described public policy when incorporated in rules – if still the latter is meant, then the Rome Convention adds a fourth meaning of «mandatory rules» – as public policy rules.) 125

Here, «mandatory rules» will mean only mandatory rules in the wide sense. 126

III. Summary

Freedom of contract is granted through the delegation to contract as one wishes in fields in which there are no rules whatsoever and in fields in which there are rules that one can derogate from (dispositive rules). The limitation of the freedom of contract is realised through mandatory rules, which on their side can be internally mandatory rules, internationally mandatory rules and mandatory (socially) protective rules, and through the *ordre public*, which can be, but not necessarily is, incorporated in objective rules (the latter being simultaneously also internationally mandatory rules).[140] 127

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[139] – for instance, *ICC Case No. 8528,* 25 et seqq.

[140] SCHNYDER, for example, makes the following classification of rules in the field of insurance contract law: «non-mandatory rules», «mandatory rules in relative terms», «mandatory rules in absolute terms» and «<unequivocal> or <qualified> mandatory rules and/or provisions which form part of public policy» (SCHNYDER, EC International Insurance Contract Law, 590 and the references therein).

Chapter 9: Characteristics

I. Definition

1. Overriding mandatory rules

1.1 Legislation

a Switzerland

128 Swiss law does not provide an explicit definition of overriding mandatory rules. The characteristics of the latter can be extracted from Art. 18 PILA[141] and Art. 19 PILA. Art. 18 PILA concerns Swiss overriding mandatory rules; Art. 19 PILA concerns foreign overriding mandatory rules. In fact, whether they are foreign or domestic is not relevant for their characterisation as overriding mandatory (it might be relevant for their treatment, especially by state courts, but that is another question). This is also why the specifying of such origin by the mentioned legislative texts will be omitted here when constructing the definition of overriding mandatory rules.

129 Art. 18 PILA talks about «provisions … which, because of their special aim, are to be applied mandatorily, irrespective of the law designated…». One can infer from this that overriding mandatory provisions feature a special goal, a requirement that they are applied always (including when they do not belong to the *lex causae*) and a causal link between these two elements.

130 Art. 19 PILA is less descriptive than Art. 18 PILA and allows one to deduct only one of the characteristics pointed out in the latter – the mandatory applicability: a «provision … which wants to be applied mandatorily…». Art. 19 PILA most probably owes its laconic language to having been premised on the fact that Art. 18 PILA already contains the details.

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[141] Whether Art. 18 PILA concerns overriding mandatory rules or positive *ordre public* and whether those two concepts are distinct will be addressed in Chapter 11, IV.

To sum up, for PILA an overriding mandatory rule is a rule that has a special goal, and due to this special goal, it has to be applied always – even where the law to which it belongs does not govern the case.

b EU

EU law has given an explicit definition of overriding mandatory rules for the first time – the first paragraph of Art. 9 Rome I[142] provides: «Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract ….»[143]. The main points here are: relevance of the rules in question for a public interest which can be (but is not limited to) a political, social or economic interest; importance of the safeguarding of such interest; applicability of these rules which does not depend on whether they belong to the *lex causae* or not (applicability at any price, mandatory applicability). Unlike the German version, the English version does not specify that overriding mandatory rules are provisions which are «mandatory» (i.e. that overriding mandatory rules are a type of mandatory provisions), but it does not need to, as that is clear already from the term – «overriding *mandatory* provisions» (from the German term it is not clear, since the word «mandatory» («zwingend» or similar in German) is not contained – «Eingriffsnormen»). 132

c Comparison between Swiss and EU law

EU law is more detailed than Swiss law. It explains that overriding mandatory rules are connected to a public interest and even gives examples of such public interests – political, social or economic. Swiss law talks about a special goal 133

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142 Rome II does not have an explicit definition of overriding mandatory rules.

143 The concept of «overriding mandatory provisions» embedded in Art. 9 Rome I is a pan-European concept, not one of the national law of a EU Member State («This is a European, not Greek Law concept…» – *Eurobank Ergasias v Kalliroi [2015] EWHC 2377 (Comm)* – i.c. a Greek banking rule allegedly rendering a commission related to an English-governed loan granted by a Greek bank illegal was denied the characterisation of an overriding mandatory rule).

without elaborating on the character, in particular on the cause, of this speciality of the goal. However, it should also be admitted that the wording of the Swiss law («special aim» – Art. 18 PILA), at the end, achieves as much as that of the EU law («provisions the respect for which is regarded as crucial by a country for safeguarding its public interests» – Art. 9 (1) Rome I) and even more because it is broader – having a special purpose can include the serving of a public interest and in addition having other special aims.

134 Otherwise Swiss and EU law have the following similarities. Under both, overriding mandatory rules are to be applied obligatorily regardless of any potential belonging to the *lex causae*. Both indicate a causal link between the substantive content of the concerned rule and the compulsiveness of such a rule's applicability – the rule is mandatorily applicable exactly because of the substantive goal it is trying to achieve, in particular because of the importance of that goal. This nexus is visible from the phrases «because of» in Art. 18 PILA and «crucial … to such an extent that…» in Art. 9 (1) Rome I.

135 In effect, it could be said that the Swiss «definition» in Art. 18 and 19 PILA and the EU definition in Art. 9 (1) Rome I are more or less the same. In fact, the predecessor of the latter which was in force at the relevant time – Art. 7 of the Rome Convention – was followed when creating PILA[144] [145].

1.2 Literature

136 According to SCHNYDER, overriding mandatory rules are domestic or foreign norms which claim to be applicable regardless of the appointed law. They determine their spatial scope independently from the references made by private international law because they are of a special imperative nature.[146]

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[144] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315.

[145] Though this Art. 7 of the Rome Convention did not devote a whole separate paragraph to the defining of overriding mandatory rules as Art. 9 (1) Rome I does today, quite some features of the concept of overriding mandatory rules could be extracted from it, and thus taken as a model.

[146] SCHNYDER, Wirtschaftskollionsrecht, *passim*.

According to KARRER, who sees them as «a modern version of the French concept of «*lois de police*»»[147], overriding mandatory rules are norms of public law or of private law which in the respective law are to apply in an absolutely mandatory way and *sua sponte* and which, from the point of view of private international law, are *lois d'application immédiate*.

One can refer also to VOSER's definition of overriding mandatory rules of the *lex fori*. In her view, the latter are material norms with a unilateral, related-to-them conflict of laws rule, through which the law maker wanted to ensure the applicability of the domestic law (express *lois d'application immédiate*) or through which it would have ensured the applicability of the domestic law had it thought of the applicability of the material norm in international situations (implicit *lois d'application immédiate*)[148]. 138

KÖHLER discusses overriding mandatory rules in a formal and in a material sense. He seems to understand the former as substantive rules to which an explicit (contained in them or separately) unilateral conflict of laws rule attaches. This conflict of laws rule is *lex specialis* towards the general conflict of laws rule and, because of being such *lex specialis*, leads to the concerned substantive rules asserting themselves against the substantive rules designated by the general conflict of laws rule. Overriding mandatory rules in a material sense appear to be deemed by KÖHLER as substantive norms (only) which, upon interpretation of their purpose (and not simply their wording which might show differently), are not encompassed by the general conflict of laws rule but need to be connected to autonomously, and, thus, assert themselves against the substantive rules designated by the general conflict of laws rule.[149] 139

1.3 Proposed definition

Overriding mandatory rules are material law rules whose content is so important for the society that conflict law provides that they are to be applied or 140

[147] KARRER, BSK IPRG, Art. 187 N 230.

[148] VOSER, Lois d'application immédiate, 133.

[149] KÖHLER, 5-102.

considered always, regardless of whether the law to which they belong governs the matter or not.

2. Financial overriding mandatory rules

2.1 Definition

141 Financial overriding mandatory rules are overriding mandatory rules concerning the financial sphere. Their material law content protects the public interests that can be touched upon in the course of concluding financial transactions. In order to accomplish such protection, they regulate the financial transactions (loans, equity and debt securities, derivatives, insurance products, etc.), the persons participating in or facilitating the conclusion of the financial transactions (banks, insurers, funds, collective investment schemes, stock exchanges, investors, etc.) and the methods of concluding those (i.e. the financial services)[150]. Financial overriding mandatory rules are e.g. currency regulations[151], requirements for securities trading, restrictions on movement of capital, bans on financial services providers from offering services in the territory or to the citizens of a country, etc.

2.2 Frequent presence of status of financial markets law as overriding mandatory law

142 Nowadays, overriding mandatory rules are ever more enacted, especially with regard to economic – and in particular financial – transactions. Financial markets law is even said to be «archetypical overriding law»[152]. As became clear (see Chapter 5, Subchapter 1, V.), financial transactions often touch upon public interests and the latter are namely the subject matter of overriding mandatory rules. Globalisation in the financing business has also played a role. It was mentioned in Chapter 5, Subchapter 1, IV. that it has led to financial transactions being able to touch upon the interests of other jurisdictions, except of the

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[150] See also MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 16 as well as SEBASTIANUTTI, International financial law, Part 5.

[151] VOSER, Lois d'application immédiate, 203.

[152] LEHMANN, 533.

jurisdictions within which these transactions are concluded. That has motivated the legislators of the other jurisdictions to regulate the effects of such foreign (to them) financial transactions, and such regulating necessarily happens through the enactment of extraterritorially applicable law, like overriding mandatory rules.

2.3 Frequent absence of status of financial markets law as international ordre public

Whilst frequently characterised as overriding mandatory law, financial markets law would rarely be characterised as international *ordre public* law. That is also why the problem discussed here of the treatment of this law by Swiss international arbitration arises – if it belonged to international *ordre public* its treatment would have been clear: as per Art. 190 (2) (e) PILA it would have had to be complied with by international arbitrators adjudicating out of Switzerland. Financial market rules are very important to it but rarely constitute some of the real fundamentals of social life. The prevailing view in the literature and the jurisprudence is that market regulation and economic regulation are not part of the *ordre public*[153]. With its famous decision *Terra armata* (see cons. 3.2 and the third paragraph of cons. 3.1), the Court denied competition law the status of *ordre public* under Art. 190 (2) (e) PILA: this law was found to be an instrument only of some but not of all economies; planned economies with more state intervention, for example, did not resort to it, and such planned economies could not be held out as immoral or contrary to the fundamental principles of law. That logic might be applied also to financial market regulation – namely also market regulation. On the other side, one cannot exclude financial markets law altogether from the space of international *ordre public*. Some of its rules will belong to the latter – mostly those that also have other subjects of protection apart from the financial market (e.g. anti-money-laundering rules). 143

II. Terminology

1. Legislation

[153] PFISTERER, Art. 190 N 86.

Swiss law still lacks a specific legislatively established term for the concept of overriding mandatory rules. Only descriptive phrases such as «provisions … which, because of their special aim, are to be applied mandatorily, irrespective of the law designated…» or «provision … which wants to be applied mandatorily…» exist in Art. 18 (respectively 19) PILA. Within the EU, Rome I has brought some clarity to the terminology. In its English version, it speaks of «overriding mandatory rules». The German translation refers to «Eingriffsnorm» (for singular; respectively «Eingriffsnormen» for plural) which puts a certain end to the dispute on the German term[154]. 144

2. Literature

145 The terminology in the literature is not universal. It was already mentioned above that «mandatory rules», «qualified mandatory rules», «internationally mandatory rules» and «unequivocally mandatory rules»[155] are synonyms of «overriding mandatory rules». In addition, in the various writings one can encounter, for example, «*lois d'application immédiate*», «absolute rules in the *lex fori*», «spatially conditioned internal rules», «*lois de police*», «peremptory rules»[156]. Though this is not clear from its wording, the term «*lois d'application immédiate*» covers the immediately applicable rules only of the *lex fori*, and not of any *lex*, which means that it cannot be a synonym for, but is «solely» a type of, «overriding mandatory rules». «Absolute rules in the *lex fori*» which is a quite precise term, on the other hand, makes it clear that it refers only to rules of the forum. The indication of the spatial application in the term «spatially conditioned internal rules» (present also in the Italian term «norme sostanziali spazialmente delimitate» (in English something like «spatially lim-

154 SCHNYDER, IPR der Leistungsstörungen, 212. Own translation from German.

155 In connection to insurance contract law, SCHNYDER uses, amongst others, the term «unequivocal mandatory rules» (SCHNYDER, EC International Insurance Contract Law, 590). This is a suitable term, although it might be better to use an adverb («unequivocally») – «unequivocally mandatory rules» – as done here, rather than an adjective («unequivocal») – «unequivocal mandatory rules» – so as to show that the unequivocalness characterises the rule's mandatory nature, and not merely the rule.

156 VOSER, Lois d'application immédiate, 6.

ited substantive norms»)) is unexplainable because *lois d'application immédiate* rather touch upon more territories than only one. Some authors use «*lois de police*» and «*lois d'application immédiate*» as synonyms of each other and sometimes both of those terms – as synonyms of «mandatory rules»[157]. «*Lois de police*» seems to be wide and mean simply «mandatory rules» rather than «*lois d'application immédiate*» because it neither indicates an overriding nature of the mandatoriness of the rules nor belongingness of those to the *lex fori*.

As far as other (than English) languages are concerned, there are for example: 146
the already mentioned German term «Eingriffsnorm» (for singular; respectively «Eingriffsnormen» for plural), the French «dispoitions internationalement imperatives», and the Italian «norme di applicazione necessaria»[158] [159]. «Eingriffnormen» has been increasingly used. Literally translated into English it means «interfering norms», «intervening norms», «interference norms»[160] or «norms that interfere» or «norms that intervene» (from «Eingriff» – «interference», «intervention» and «Normen» – «norms»), and as a matter of fact it is very precise as it connotes an act of interfering which indeed happens in practice[161]. In addition, the English «overriding mandatory rules» and the German «Eingriffsnormen» correspond well to each other – they both show supersession by the norms in question of other norms.

3. Proposed terminology

Even if a precise term would bring about clarity and, thus, legal certainty, its 147
practical significance would not be that great because a rule would apply as overriding mandatory as long as it has the described characteristics regardless

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157 See GIRSBERGER/VOSER/COLACINO//DONCHI, 1373-1377 and citations there.

158 KAUFMANN-KOLHER/RIGOZZI, 7.92.

159 See VOSER, Lois d'application immédiate, 5, 6 for further terminology.

160 Also, SCHNYDER uses this term in English – SCHNYDER, Conflicts of Law, 435.

161 KAUFMANN-KOHLER/RIGPZZI consider it even «more telling» than the terms in other languages, 7.92.

of whether it is expressly called «overriding mandatory», which would anyway seldom be done[162]. Still, uniform terminology is always the better option. It is apparent that something should be added to «mandatory rules» in order to specify the nature of the mandatoriness. This could be e.g. one of these adjectives, adverbs and substantives: «overriding», «internationally», «unequivocally», «qualified»[163], «interference», «interfering». «Overriding» has been used in a law – Art. 9 of Rome I – and though such law is not Swiss (but EU), this presence of some legislative use strengthens the justification for a reference to it and hence to «*overriding* mandatory rules».

III. Types

148 Overriding mandatory rules can be substantive or procedural. Most often substantive ones are those being referred to, and that is also the case here.

IV. Sources

149 Overriding mandatory rules can originate from public (both regulatory and criminal) or private law. In any case, however, they are «at least close to public law»[164]. Overriding mandatory rules of the forum – *lois d'application immédiate* – are «functionally» public law norms[165]: even where they are contained in private law norms, they still protect some (forum's) regulatory interests.

150 Then, overriding mandatory rules can be contained in national, supranational or international law.

151 Overriding mandatory rules would often be situated outside the private law act governing the contract – in a separate, e.g. regulatory or criminal, statute. That would be so where they are of a public law character (which is often the case)

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[162] SCHNYDER, Conflicts of Law, 435.

[163] – even if «qualified» only indicates the presence of a special character without making it clear what the latter consists of.

[164] VISCHER, ZK IPRG, Art. 18 N 2.

[165] VOSER, Lois d'application immédiate, 36, own translation from German.

and it is the reason why it is so difficult to know of the relevance of an overriding mandatory rule in the first place.

V. Components

1. Special objective

The most important distinguishing feature of overriding mandatory rules is their special purpose, which is special because it consists of the protection of very important interests – namely public interests (health protection, human rights, environmental protection, preservation of the cultural heritage, economic policy, etc.[166]). 152

It would be most logical to extract the characterisation of this purpose of the overriding mandatory rule as very important from the law which contains the overriding mandatory rule. On the other hand, one can argue that also the *lex causae* should have a say, and probably the *lex fori*, or the law applicable to the parties, and so on and so on – in an international situation, many laws may become relevant. Yet one should at least start with the «opinion» of the legislation which contains the overriding mandatory rule and as an additional criterion check if another law – be it the *lex causae*, the *lex fori* or a third law (the idea is simply to make a comparison) – protects the same interests[167]. 153

Such special purpose is a part of the material law content of the overriding mandatory rule. 154

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[166] See also KAUFMANN-KOHLER/RIGOZZI, 7.93, where «mandatory rules» is a synonym of «overriding mandatory rules» (as can be inferred from the previous paragraph – 7.92) and where the authors apparently consider mandatory (socially) protective rules as a type of overriding mandatory rules rather than a category equal and parallel to overriding mandatory rules.

[167] SCHNYDER, Eingriffsnormen im Versicherungskollisionsrecht, 626. The author gives the examples of Liechtenstein's insurance law provisions on the obligatory use of national language in insurance contracts, the prohibition of the cancellation of the contract and others being encountered also in German and Austrian legislations.

2. Willingness to apply mandatorily

In order to be qualified as overriding mandatory the rule in question itself should want to be applied. «The scope of application of the rule, whether express or implied, will tell» if there is willingness[168]. This willingness means that «the state enacting the rule intended it to apply to international situations»[169]. 155

156 Thus, it is the law that contains the overriding mandatory rules which should be calling for overriding mandatoriness, whereby it does not play a role if such law is *lex cause*, *lex fori* or a third law[170].

157 This willingness of the qualified mandatory rule to apply mandatorily is its conflict of laws component[171] – an implied conflict of laws rule. As contended, every material law norm, even a domestic one, needs a conflict of laws rule in a wide sense which «declares» its applicability. In fact, there is a debate in the literature, with regard to the overriding mandatory rules of the *lex fori* in particular, on whether the material norms which such overriding mandatory rules contain are their only content and the trigger of their applicability or whether also conflict of law rules are contained. VOSER does not agree with Francescakis that the *lois d'application immédiate* define their scope of application on their own[172]. She believes that conflict of law rules are in any case needed; they built a logical autonomous supplement to material norms[173]. VOSER even doubts the very need of Art. 18. PILA, stating that the latter incorporates the «"given"»[174] – probably she believes that the function of this article (to order overriding mandatoriness) will already have been performed by the conflict of laws rule which, she deems, is contained in the *loi application immédiate*. If a

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168 KAUFMANN-KOHLER/RIGOZZI, 7.98 wth regard to Art. 19 PILA.

169 KAUFMANN-KOHLER/RIGOZZI, 7.98.

170 *ICC case No. 8528*.

171 The order for the special scope of application of the overriding mandatory rules «is the conflict of laws mechanism» of the overriding mandatoriness – SCHNYDER, Wirtschaftskollisionsrecht, 56 (end of first paragraph), own translation from German.

172 VOSER, Lois d'application immédiate, 125 and *passim*.

173 VOSER, Lois d'application immédiate, 125-127 and *passim.*

174 VOSER, Lois d'application immediate, 284, own translation from German.

conflict of laws rule is anyway present, the term «*lois d'application immediate*» used for overriding mandatory rules *legis fori* will be imprecise because the application will not be derived from the *loi* itself, but from the conflict of laws rule. VOSER also underlines the inaccuracy of the term but considers that there is no better term. Here the terms «overriding mandatory rules of the *lex fori*» or «overriding mandatory rules *legis fori*» are considered better alternatives.

3. Causal link between the willingness of the rule to apply mandatorily and the special objective

An overriding mandatory rule wants to be applied mandatorily, namely in order to attain the special objective it has. 158

VI. Legal consequences

1. Legal consequences

Overriding mandatory rules can produce administrative, criminal and/or civil law consequences. Only the latter will be enforceable in international arbitration, and in arbitration as a whole. For instance, an administrative law consequence of a financial overriding mandatory rule will be the withdrawal of a licence, a criminal law consequence will be imprisonment (e.g. in case of money laundering or insider dealing), and a civil law consequence will be the voidability or voidance of a contract, claim for damages, etc. 159

2. Civil law consequences

2.1 Direct

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The direct civil law consequences of an overriding mandatory rule concern the «destiny of the legal relationship between the parties»[175]. They are the consequences that stand the closest in time to the act of applying or considering the overriding mandatory rule.

161 The overriding mandatory law itself could define them, as does, for example, Art. 26 of the Swiss Federal law of 16 December 1983 on the acquisition of real estate by persons abroad (nullity of transactions concluded without the necessary permission) or Art. 101 (2) TFEU (nullity of arrangements violating EU competition law).

162 However, the overriding mandatory law in question might also omit to determine its direct consequences, in which case separate rules will have to be consulted. In Switzerland, such rules will be Art. 20 CO or Art. 97 respectively 119 CO[176]. The first article prescribes nullity of a contract with illegal content and the last two prescribe subsequent impossibility to perform a contract, in particular objective impossibility under the law[177]. Nullity of the contract is present when the overriding mandatory rule infringed by the contract was subsisting at the time of the latter's conclusion, and subsequent impossibility of the contract's performance is present when the overriding mandatory rule violated comes into effect only after such conclusion. It should be noted that, even if, read strictly, Art. 20 CO deems itself applicable to violations of any

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[175] VOSER, Lois d'application immédiate, 272, *in initio* with regard to the direct legal consequences of overriding mandatory rules of the *lex fori (lois d'application immediate*) under Art. 18 PILA, own translation from German.

[176] Wihin the material law approach, these articles were the basis for applying or considering the respective overriding mandatory rules. Here, under the conflict of laws approach, they have another mission – to regulate the consequences of an already applied or considered overriding mandatory rule.

[177] In this sense, with regard to *lois d'application immédiate* in particular, VOSER, Lois d'application immédiate, 273.

law[178], case law and literature are of the view that Art. 20, 97 and 119 CO are not applicable to every violation of an overriding mandatory rule. The authorities consider, for example, that there is nullity of the contract only where the meaning and purpose (not necessarily the wording) of the violated overriding mandatory rule so demand. For instance, the violation of a rule that prohibits the participation by certain parties in a particular type of contract does not render the contract void unless collective interests are involved (the infringement by a foreign broker of the prohibition on activity in Switzerland without a licence does not lead to nullity of the contract[179], whilst medical doctors, lawyers or notaries whose work touches upon public interests need an authorisation in order to conclude contracts[180]). Thus, it is apparent that where the overriding mandatory law does not define its direct consequence, one cannot presume voidance of the contact. One needs to elaborate criteria here. Importance and unambiguity of the violated overriding mandatory rule might be such: where the rule is very important and clear (in the financial sphere, due to the complex relations, clarity might not always be present), the contract would be void, and where it is not very important or not clear, the contract would be voidable.

2.2 Indirect

The indirect civil law consequences of an overriding mandatory rule are those that «regulate … the just balance between the interests of the parties after the 163

[178] Also VOSER, Lois d'application immédiate, 273, *in initio* underlines that Art. 20 CO appears to cause nullity automatically. She considers the context of mandatory norms imposing prohibitions and Art. 20 CO appears, in her view, to trigger the nullity of the violation of any such norm.

[179] *DSC 62 II 108 of 19 February 1936*, 111; *DSC 114 II 279 of 21 June 1988*, 281, cons. 2, b); *DSC 117 II 47 of 13 March 1991*, 48, cons. 2, a), second paragraph.
Similarly, in Germany a violation of the prohibition on performing certain banking activities without the required licence does not automatically lead to voidance of the concluded contracts but only creates a right of the German financial regulator – Bundesanstalt für Finanzdienstleistungsaufsicht («Bafin») – to order the winding-up of those (§ 37 (1) German Banking Act) which right might also remain unexercised.

[180] *DSC 117 II 47 of 13 March 1991*, 48, cons. 2, a), second paragraph.

direct consequence … has been already clarified»[181]. They are less close to the act of applying or considering the overriding mandatory rule than the direct consequences – they are the result which comes after the latter. The question about them «concerns in particular the civil law consequences of the nullity of the contract»[182], such as rescinding of the contract, unjust enrichment or tort claims[183].

[181] VOSER in respect of the indirect consequences of *lois d'application* immediate under Art. 18 PILA (VOSER, Lois d'application immédiate, 277 – own translation from German).

[182] VOSER, Lois d'application immédiate, 278, *in initio* (own translation from German).

[183] Again there – VOSER, Lois d'application immédiate, 278, *in initio*.

Chapter 10: Examples

I. Non-economic overriding mandatory rules

Overriding mandatory rules which do not concern the economic sphere are e.g. those protecting public health, human rights, the environment, the cultural heritage. 164

II. Economic overriding mandatory rules

Economic law participates in the producing of overriding mandatory rules mainly through: competition law, import and export provisions, trading with the enemy legislation, capital market controls (e.g. emergency laws), currency controls, legislation on the acquisition of land by persons abroad, prohibitions or restrictions on export of food (in cases of shortage)[184] or economic sanctions by one country against another imposed for political reasons. 165

III. Financial overriding mandatory rules

1. Examples according to type

One can talk about institutional and transactional financial overriding mandatory rules. The former will concern the financial markets participants as institutions – or their organising as legal persons – e.g. rules on licences, minimum capital, minimum solvency ratio. Transactional financial overriding mandatory rules will regulate the carrying out of the business – anti-money-laundering provisions, rules against the financing of terrorist activities, currency exchange regulations etc. 166

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[184] SCHNYDER, IPR der Leistungsstörungen, 211. VOSER, Lois d'application immédiate, 203 gives as examples for prohibitions or restrictions on export of food the US and Polish bans on exporting soya beans and sugar after bad harvests; in Switzerland the export of existential goods can be restricted by resorting to Art. 28 (1) of the Federal Law on National Economic Supply.

Financial overriding mandatory rules can also be initial and prudential. The initial type are to be implemented at the beginning of the activity of the financial markets participant. Many of the institutional financial overriding mandatory rules – e.g. the requirement for obtaining a licence – are such initial financial overriding mandatory rules. Prudential financial overriding mandatory rules are the financial overriding mandatory rules which apply throughout the whole financial business activity of the respective person. Both the institutional and the transactional financial overriding mandatory rules can be prudential, with the latter always being such.

168 Financial overriding mandatory rules regarding the normal course of business are those financial overriding mandatory rules enacted under ordinary economic circumstances in order to prevent a crisis and safeguard certain rights. They are valid for an indefinite period of time. The prohibition on securities fraud, capital requirements or publicity duties are amongst them. On the other side are the crisis-determined financial overriding mandatory rules, such as capital controls, which are introduced upon the occurrence of an economic and/or financial crisis and aim at mitigating such a crisis. Their effect is temporary, for a short (but sometimes, if the situation does not improve, longer) period.

2. Examples in different laws

169 The following Swiss legal acts regarding the financial sector might incorporate overriding mandatory rules: the Federal Act on Banks and Savings Banks of 8 November 1934; the Federal Act on the Swiss National Bank of 3 October 2003; the Federal Act on the Supervision of Insurance Companies of 17 December 2004; the Federal Act on Collective Investment Schemes of 23 June 2006 («CISA»); the Federal Act on Stock Exchanges and Securities Trading of 24 March 1995 («SESTA»)[185]; the Federal Act on the Financial Market Infrastructures and the Market Conduct in Securities and Derivatives Trading of

[185] However, large parts of it were repealed and the respective issues are now regulated by the new Federal Act on the Financial Market Infrastructures and the Market Conduct in Securities and Derivatives Trading («FMIA»).

19 June 2015 («FMIA»); the Federal Act on Intermediated Securities of 3 October 2008; the Federal Decision on Protection of the Currency of 8 October 1971 and the ordinances of the Federal Council supplementing that decision, such as the Ordinance on the Measures against inflow of foreign monies of 20 November 1974 and its amendment from 22 January 1975[186]; the Criminal Code of 21 December 1937 («CrimC»); the Federal Act on Combating Money Laundering and Terrorist Financing in the Financial Sector of 10 October 1997 («AMLA»); the Federal Act on the Execution of International Sanctions of 22 March 2002 («Embargo Law») and some ordinances enacted under it, like the Ordinance on economic measures against Iraq of 7 August 1990, the Ordinance on measures against Zimbabwe of 19 March 2002, the Ordinance on measures against the Central African Republic of 14 March 2014 or the Ordinance on measures against the Islamic Republic of Iran of 11 November 2015; the Federal Act on external economic measures of 25 June 1982; the Ordinance on the Liquidity of Banks of 30 November 2012; the Ordinance concerning Capital Adequacy and Risk Diversification for Banks and Securities Traders of 1 June 2012; and eventually, the Federal Act on Financial Services («FinSA») and the Federal Act on Financial Institutions («FinIA») adopted on 15 June 2018 and likely to enter into force on 1 January 2020. For instance, in one decision, the Swiss Federal Banking Commission applied Art. 18 PILA and subjected a takeover bid which targeted a non-Swiss (Luxembourgish) company to SESTA, in particular to Art. 22 (1) SESTA (now repealed)[187]. In addition, the Swiss Federal Administrative Court characterised the reporting and tender obligations of Swiss stock exchange law as *lois d'application immédiate*[188].

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[186] – an example (of Swiss currency regulations) given by VOSER, Lois d'application immédiate, 203. The Court held null a contract clause violating the prohibition on interest yield for foreign deposits imposed by the Ordinance – *DSC 110 II 360 of 13 March 1984*.

[187] – *Decision of the Upper Chamber of the Swiss Federal Banking Commission of 30 September 1999* concerning an offer by LVMH Moët Hennessy Louis Vuitton to TAG Heuer International SA, as cited in MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 16.

[188] – *B-1215/2009 of 9 November 2010 of the Swiss Federal Administrative Court*, cons. 7.1.2ff., as cited in MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 16.

170 Financial overriding mandatory rules in the EU are contained in Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (Market Abuse Directive) or in Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps. For instance, the latter contains a prohibition of uncovered short selling in its Art. 12 (1) and 13 (1)[189]. Further, the EU fights against money laundering through overriding mandatory rules in Directive (EU) 2015/849 of 20 May 2015 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing.

171 An example of enactment of crisis-determined (in particular determined by a public debt crisis) financial overriding mandatory rules is witnessed in the Greek jurisdiction. In 2010 a Hellenic Financial Stability Fund («HFSF») was established through Law 3864/2010 on the Hellenic Financial Stability Fund as a state-owned private legal entity, a special purpose vehicle created to «contribute to the maintenance of the stability of the Greek banking system, for the sake of public interest». Among the competences of HFSF was the extension of capital aid to financial institutions. The HFSF became a shareholder in certain credit institutions (which led to new notification requirements for the other shareholders[190]). Next, capital controls were introduced in the summer of 2015 in the peak of the country's debt crisis. As of 18 November 2016, they are still in force, though to a certain extent eased. In a nutshell, forced bank holidays were announced, cash withdrawals from any branch or cash dispenser of credit institutions in Greece or abroad were limited to EUR 60 per depositor per credit institution per day (or EUR 420 per week), the transfer of funds or cash abroad was prohibited (with certain exceptions in cases of transfers to

[189] LEHMANN, 544.

[190] E.g. upon HFSF acquiring or selling a certain amount of an institution's shares, apart from it being under a notification duty, other shareholders of the respective institution became obliged to notify the percentage of shares they held after considering the percentage of shares which the HFSF had announced to hold.

children studying abroad up to a certain amount or of transfers for health purposes), large bill payments to foreign suppliers had to be approved by a government commission (with preferences for payments regarding certain products such as medicines), Greek citizens were prohibited from opening foreign bank accounts or buying shares abroad.[191] The restrictions applied to «credit institutions that operate in Greece in any form, including branches of foreign credit institutions within the scope of Law 4261/2014 (Government Gazette issue A 107), the Consignments and Loans Fund, payment institutions under Law 3862/2010 (Government Gazette issue A 113) and electronic money institutions under Law 4021/2011 (Government Gazette issue A 218) and branches and agents of payment institutions and electronic money institutions established in other states and lawfully operating in Greece…»[192].

172 On 22 March 2013, Cyprus enacted two laws connected to its banking crisis: The Resolution of Credit and Other Institutions Law («Law 17(I)/2013») and The Enforcement of Restrictive Measures on Transactions in Case of Emergency Law of 2013 («Law 12(I)/2013»). Restrictive measures were imposed that included, for example, limitations on cash withdrawals and on export of cash as well as prohibitions on cashing cheques and making payments and transfers of funds outside and inside Cyprus (with certain exceptions for payments made within the normal business or associated with salaries or expenses for studies). Ensuing decrees under Law 12(I)/2013 modified the measures.

173 In 2011, Argentina adopted restraints on currency and trade in order to protect its foreign currency reserves that had decreased. Among those were foreign exchange controls which restricted the purchase and sale of foreign currencies, including and especially of US dollars (otherwise popular among Argentinian

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191 These rules objectively violated the free movement of capital granted under Art. 63 TFEU but were adopted under the exception the latter allows for situations where public policy interests need to be protected – Art. 65 (1) (b), *in fine* TFEU.

192 Art. 1, point 1 of the Greek legislative act «Urgent provisions for imposing restrictions on cash withdrawals and capital transfers» (G.G. issue A 84, 18.07.2015), as applicable (G.G. issue B 1561/24.7.2015), (G.G. issue A 90, 31.7.2015), (G.G. issue B 1617, 31.7.2015), (G.G. issue B 1620, 1.7.2015), (G.G. issue B 1721, 17.8.2015), (G.G. issue B 1867, 1.8.2015), (G.G. issue B 1871, 3.9.2015), (G.G. issue B 2100, 25.9.2015), (G.G. issue B 2110, 29.9.2015) and (G.G. issue B 2131, 2.10.2015).

savers). This concerned both individuals and companies. Cash withdrawals were limited. Bank holidays were announced. Accounts above a certain threshold were converted into fixed-interest savings accounts and those in dollars were converted into Argentinian peso accounts. A yearly mandatory bank deposit in foreign currency applied to thirty percent of the inflows of funds in Argentine financial institutions. The controls were removed at the end of 2015.

174 As of 26.01.2016, the Dutch Financial Markets Amendment Act 2015 obliges banks' employees to take an oath in which they, *inter alia*, promise to perform their duties with integrity and care, to balance the interests of customers, shareholders, employees and the society in which the bank operates, and to put the interests of the client at the forefront within this balance. This rule seems to have been intended to address problems of the financial market, which have proved themselves sensitive throughout the financial crisis. It will be interesting to see if that rule will have any impact on civil law relations. And if it does, it will be even more interesting to see whether it has an influence in particular on international civil law relations, i.e. whether it will be deemed as so important that e.g. a cross-border contract concluded by a bank through an employee who has not taken the oath will be void or voidable.

175 Two Cuban decrees provide examples for exchange control regulations. Decree No. 13 of 1948 required all obligations paid in Cuba to be executed in the Cuban currency (Cuban pesos), and Decree No. 568 of 1959 required all payments to Cuban nationals to be rendered in Cuba. The aim of these acts was to preserve the supply of foreign exchange in Cuba through keeping Cuban pesos in the country and, in so far as possible, attracting into it dollars owed to Cubans.

176 The Mexican exchange control regulations scrutinised in the case of *Braka v Bancomer, S.A., 589 F. Supp. 1465 (S.D.N.Y. 1984), aff'd 762 F.2d 222 (2d Cir. 1985* and the case of *Callejo v Bancomer, S.A., 764 F.2d 1101 (5th Cir. 1985)* – both cases as cited by MARKS, 120 – imposed the conversion of domestic debts denominated in foreign currency into Mexican pesos at an official (lower) rate.

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An Italian law, involved in the English case *Wilson, Smithett & Cope Ltd. v Teruzzi*[193], required residents in Italy to obtain a ministerial permission for incurring obligations against non-residents. The purpose was to preserve the country's exchange resources through inhibiting residents from exporting capital.

United City Merchants (Investments) Ltd. v Royal Bank of Canada[194] concerned Peruvian regulations which restricted the export of currency out of Peru by private persons for reasons of preserving the supply of foreign exchange of the country. 178

Czechoslovakian capital regulations were invoked in a case leading to a French judgment from 16 October 1967[195]. In order to protect the country's reserves of foreign exchange, they restricted the export of capital, including of foreign currency, by Czechoslovakian citizens.[196] 179

Frantzmann v Ponijen case[197] involved Indonesian regulations that required a licence for currency exchange contracts. The adjudging Dutch court defined the contract at stake – a promissory note to pay Dutch currency in return for Indonesian currency – as covered by these regulations and (since the envisaged licence had not been obtained) refused enforcement based on Art. VIII (2) (b) of the Bretton Woods Agreement. 180

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193 *[1976] 2 W.L.R. 418 (C.A.), [1976] 1 All E.R. 817*.

194 *[1982] 2 W.L.R. 1039 (H.L.), [1982] 2 All E.R. 720*.

195 *Cass. Civ. 1re, Fr. (Arrêt No. 746; Pouvoir No. 65-12.879)*.

196 Even though the court deemed it to be against French public policy to enforce contracts entered into with the intention of circumventing foreign law, the court enforced a contract circumventing the Czechoslovakian law, since the latter was not consistent with the Bretton Woods Agreement and thus was not protected by the latter's Art. VIII (2) (b). One cannot follow the court's logic – the violation of French public policy is a basis separate from Art. VIII (2) (b) Bretton Woods Agreement, which means that, even if the latter cannot be applied, the infringement of French public policy should still be sanctioned (by a refusal to enforce the contract whose existence causes this infringement).

197 *1960 N.J. No 290 (Dist. Ct., Maastricht, Neth.) 30 I.L.R. 423 (1960)*.

Chapter 11: Differentiation

I. Internally mandatory rules

181 For differentiation of overriding mandatory rules from ordinary mandatory rules, see above – Chapter 8, II.

II. *Lois d'application immédiate*

182 *Lois d'application immédiate* are the overriding mandatory rules of the *lex fori*. The doctrine of *lois d'application immédiate* is rooted in Art. 18 PILA for Switzerland[198]. *Lois d'application immédiate* are a type of overriding mandatory rules. *Ergo* they cannot actually be distinguished from the latter. They might have some of their own specificities, such as the ability (within a state court procedure) to prevail over competing overriding mandatory rules (in particular over competing overriding mandatory rules of the *lex causae* and of a third law) but they preserve the general characteristics of overriding mandatory rules; they are the latter.

III. Public law norms within public law relations

183 Overriding mandatory rules can be public law norms, i.e. their material law content can be a public law content (and will often be so). In this case, they might be competing with other national public laws for the right to regulate the public law dimension of the concerned international relationship, but this competing will not be analysed here. Rivalry between national public laws is the subject matter of public conflict law (which is anyway scarce), whilst the conflict law examined here is private conflict law (even if potentially influenced by public law – namely by overriding mandatory public law). Moreover, in the context of competition between national public laws, there would be no «overriding» mandatory rules: since national public laws are coequals (their

[198] For the EU in Art. 9 (2) of Rome I and respectively Art. 7 (2) of the latter's predecessor – the Rome Convention.

authors – states – are equal to each other), none of these laws would «override», i.e. be more important than, another; it would solely be defined (by public conflict law) as competent to regulate.

IV. *Ordre public*

Often, even in case law, the term «public policy», «ordre public», or «public order» is used as a synonym of «overriding mandatory rules». That is confusing, since these are generally seen as distinct concepts. Here they are considered as differing from each other – although case law cited here might use them as interchangeable terms. 184

Because overriding mandatory rules are different than *ordre public*, the regulation of the role of the latter in Swiss international arbitration (Art. 190 (2) (e) PILA renders a violation against it a ground for annulment of the arbitral award) does not help in defining the role of overriding mandatory rules within this dispute resolution procedure[199]. 185

1. On the terms

«*Ordre public*» and «public order» signify the same concept. The former term has a French and the latter an English origin. 186

Controversy can be encountered with regard to the existence of a difference between «*ordre public*» (a synonym of «public order») and «public policy». Some authors use them as different concepts[200]. Public policy is seen as one of the faces of public order, in particular as passive public order (and overriding mandatory rules as active public order). In such a constellation, public order is a common denominator of public policy and overriding mandatory 187

[199] *Ordre public*'s violation is a ground for annulment also under Art. 34 (2) (b) (ii) of the UNCITRAL Arbitration Model Law, § 1059 (2) (2) (b) of the German Code of Civil Procedure and Sec. 68 (1) in connection with (2) (g) of the English Arbitration Act 1996. It is also a ground for the refusal to recognise and enforce a foreign arbitral award – Art. V (2) (b) New York Convention or Art. 36 (1) (b) (ii) of the UNCITRAL Arbitration Model Law.

[200] See e.g. the wording «public policy *and* public order» (emphasis added) in DALHUISEN, P.R.I.M.E., 18.

rules[201]. However, other authors[202] and (notably) many standard agreements and legal acts hold «public order» and «public policy» to be interchangeable. Examples of such standard agreements and legal acts are The Hague Principles on Choice of Law (Art. 11 – the wording of the title and paras 3, 4 and 5 are clear on this), Rome I (Art. 21), the Rome Convention (Art. 16), Rome II (Recital 32 of the preamble and Art. 26), and the Inter-American Convention (Art. 5 (2) (b)). Since it is legal acts that treat them as such, «*ordre public*» and «public policy» will be here used as synonyms. Keeping also in mind that, as mentioned above, «ordre public» is a synonym of «public order», all three – «*ordre public*», «public order» and «public policy» – will be synonyms.

2. Definition

188 *Ordre public* consists of ideals, concepts or thoughts[203] which are fundamental for a legal system – «legal thoughts which stand in the basis of the sense for law in the country and of the natural law»[204]. *Ordre public* is a very abstract

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201 It is indeed possible for public policy and overriding mandatory rules to have a common denominator because they were born from the same consideration – the thought to protect general interests. At the same time, there is no great need for finding this common denominator because public policy and overriding mandatory rules can function independently from each other.

202 See GIRSBERGER/VOSER/COLACINO/DONCHI, 1400 who use the term «public policy» (more precisely, «international public policy») when commenting on a provision which speaks of «*ordre public*» (and is read as meaning international *ordre public*) – Art. 190 (2) (e) PILA – which cannot mean anything other than that he considers them synonyms. See further JAGUSCH, 5.125, first sentence. Also in unofficial translations of German-speaking Swiss judgments into English, the German term «*ordre public*» is translated into English as «public policy» (see e.g. the translation of *DSC 4A_414/2010 of 27 October 2010*, cons. 2.1, *in fine* under http://www.swissarbitrationdecisions.com/sites/default/files/27%20octobre%202010%204A%20414%202010.pdf (last visited on 07.02.2019)).

203 VOSER, Lois d'application immédiate, 249 speaks of «legal thoughts» (while comparing *ordre public* with *lois d'application immédiate*). Own translation from German.

204 VOSER, Lois d'application immédiate, 249 (while comparing *ordre public* with *lois d'application immédiate*). Own translation from German.

concept. Its abstract nature renders it almost undefinable (*Terra armata,* cons. 2.1); it is even compared by some to a chameleon[205].

Because it is so abstract, *ordre public* is not necessarily objective law, i.e. it is not necessarily anchored in a legal provision, in a legal act[206]. Its abstract nature is also the reason why it is able to include moral[207] values without «losing» legal character. 189

3. Types

3.1 Negative and positive

Negative *ordre public* was historically the first to be employed. It can be compared to a sort of «defence». Its task is to prevent the application within one's territory of a law which is irreconcilable with fundamental concepts of the territory's own law or of the law of the international community. Art. 17 and 190 (2) (e) PILA incorporate negative *ordre public*: the former – the Swiss negative *ordre public*, the latter – the international negative *ordre public*[208]. Similarly to overriding mandatory rules, in order for the respective *ordre public* to have the «right» to be defended, the legal system to which it belongs should be sufficiently connected to the case[209]. 190

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[205] DUTOIT, 455ff. (in particular the title of the work).

[206] VOSER, Lois d'application immédiate, 249 (while comparing *ordre public* with *lois d'application immédiate*); LEHMANN, 536.

[207] LEHMANN, 536 talks about «moral values» (own translation from German) when discussing the term «*ordre public*» contained in Art. 21 Rome I.

[208] That Art. 190 (2) (e) PILA envisages negative *ordre public* is visible from case *Not Indicated v Not Indicated*, cons. 1, b), aa): «*L'ordre public, au sens de l'art. 190 al. 2 lit. e LDIP, n'est qu'une simple clause d'incompatibilité dénuée d'effet positif ou normatif sur les rapports juridiques litigieux (ordre public négatif).*».

[209] For instance, in *DSC 125 III 443 of 30 September 1999* (in particular cons. 3, d)) Art. 17 PILA was not activated against the Islamic prohibition on interests because such a connection was missing (and also because the opposite of such prohibition – the principle of interests on capital – was not so fundamental to the Swiss legal system as to be applicable by

191 Positive *ordre public* imposes on a law that is applicable to the case the fundamental concepts of the law in force in the territory of the forum that examines the case or in the international community as a whole. The positive form of *ordre public* is rarely invoked: adjudicators have a minimalistic approach – they try to intrude into the private law relationship as little as possible and thus only in defence. Though it does not refer to it expressly, Art. 18 PILA is reckoned by most (even if not all) authors to incorporate the positive *ordre public*[210]. At the same time, it was namely this article that above the characteristics of overriding mandatory rules were inferred from (see Chapter 9, I., 1., 1.1, a.). In fact, there is a discussion in the literature as to whether positive *ordre public* and overriding mandatory rules represent the same, but this will be addressed below[211].

192 ARNOLD is right that the hindering of the application of a law through the *ordre public* reservation (the *ordre public*'s negative function) is equal to the asserting of the ideas of one's own law (the *ordre public*'s positive function), and it is therefore difficult to separate completely these two functions of the *ordre public*[212]. According to ARNOLD, whether despite such inseparability the positive function of the *ordre public* can be used for a separate goal such as the

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way of exception despite Swiss private international law's having appointed a non-Swiss law as governing).

[210] MÄCHLER-ERNE/WOLF-METTIER, Art. 17, N 3 with references regarding the prevailing opinion and the critics against it. Also, according to SCHNYDER, the positive *ordre public* is explicitly incorporated in Art. 18 PILA. VOSER, Lois d'application immédiate, *passim* disagrees that Art. 18 contains the positive *ordre public* – it does not refer expressly to it. However, according to her, historically the Swiss legislator did want to incorporate the *ordre public* in Art. 18 – this was apparent from the preparatory acts of PILA (VOSER, Lois d'application immédiate, 246). In addition, also for VOSER, Lois d'application immédiate, 247 the Court in *DSC 117 II 494ff. of 17 December 1991* acknowledges a connection between Art. 18 and the positive *ordre public*. However, she also notes (again there) that the Court was very cautious and did not hold that positive *ordre public* and overriding mandatory rules were identical, nor that they were closely related, but only that Art. 18 PILA touched upon the positive aspect of *ordre public* (see *DSC 117 II 494 of 17 December 1991, 501*, cons. 7, last paragraph).

[211] See 5.2.

[212] ARNOLD, 143.

assertion of overriding mandatory rules is also a difficult question, as he notes, not decided unanimously in Germany[213].

3.2 Procedural and substantive

Public policy has two substrates: procedural and substantive; hence, one talks of procedural and of substantive *ordre public*[214]. 193

Procedural public policy consists of the principles that shape the form in which justice is delivered – the legal procedure – or, in other words, of the basics of procedural law. According to the Court, «Procedural public policy guarantees to the parties the right to an independent judgement issued consistently with applicable procedural law as to the submissions and the facts submitted to the Arbitral Tribunal; procedural public policy is violated when fundamental and generally recognized principles were not respected, thus leading to an unsustainable contradiction with the sentiment of justice, so that the decision appears inconsistent with the values recognized by a state ruled by law»[215]. Procedural public policy includes, amongst others, the right to be heard, the right to equal treatment or the principle of *res judicata*. Violations in Swiss international arbitration of the procedural public policy (in its international form) are counteracted through raising them as grounds for setting the arbitral award aside: via Art. 190 (2) (d) PILA for infringements of the right to be heard and to equal treatment and by means of Art. 190 (2) (e) PILA for breaches of other fundamental procedural principles. 194

Substantive public policy comprises the basics of the law that regulates the material relations. The respect for material (international) public policy by Swiss international arbitrators is safeguarded through Art. 190 (2) (e) PILA's threat of annulment of the award in case of its breach. The Court gives a definition of a violation of material *ordre public*, setting very high criteria, 195

213 ARNOLD, 143.

214 *Terra armata*, cons. 2.2.1, first paragraph.

215 *Terra armata*, cons. 2.2.1, second paragraph.

amongst others, in *DSC 4A_414/2010 of 27 October 2010*, cons. 2.1[216] as well as in *4A_558/2011 of 27 March 2012*, cons. 4.1 (corresponding to *DSC 138 III 322*, 327) and the therein cited: *Terra armata*, cons. 2.2.1 and *4P.282/2001 of 3 April 2002* (corresponding to *DSC 128 III 191*), cons. 6, b). For instance, in the third paragraph of the mentioned cons. 2.2.1 of *Terra armata*, the Court holds that «an award is contrary to material public policy when it violates fundamental principles of material law in such a serious way that it is no longer consistent with the legal order and the pertinent system of values; amongst such principles are contractual trust, the respect for the rules of good faith, the prohibition of abuse of rights, the prohibition of discriminatory or confiscatory measures, as well as the protection of incapable persons.»[217]. Other decisions include also the prohibition of excessive contractual limitation of a person's freedom (*4A_558/2011 of 27 March 2012*, which corresponds to *138 III 322, 27 March 2012*). The literature adds: the prohibition of corruption, the prohibition of arrangements to smuggle goods into or out of a country and the prohibition of agreements regarding the supply of illicit drugs.[218] Contradictions in the award, for example, do not per se infringe the material *ordre public*[219]. The first time the Court annulled an international arbitral award for a violation of substantive public policy was in the above-mentioned *4A_558/2011 of 27 March 2012*, which corresponds to *138 III 322 of 27 March 2012*. The case

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[216] The Court in *DSC 4A_414/2010 of 27 October 2010*, cons. 2.1 does not expressly refer to «international» substantive *ordre public*, but this is implied, since it examines a complaint under Art. 190 (2) (e) PILA and the latter is seen as envisaging international *ordre public*.

[217] Some decisions which deal with the violations given as examples are: regarding the principle *pacta sunt servanda – DSC 4A_93/2013 of 29 October 2013* (cons. 4.2), *DSC 138 III 270 of 2 May 2012* (cons. 5.2.1); regarding the prohibition of abuse of right – *DSC 4A_490/2013 of 28 January 2014* (cons. 4.2), partially published as *DSC 140 III 75 of 28 January 2014, DSC 4A_600/2008 of 20 February 2009* (cons. 4.1); regarding the prohibition of expropriation without compensation – *DSC 138 III 322 of 27 March 2012* (cons. 4.1); regarding the prohibition of discrimination – *DSC 4A_70/2015 of 29 April 2015* (cons. 4.2), *DSC 4P.104/2004 of 18 October 2004* (cons. 6.1), *DSC 4P.207/2002 of 10 December 2002* (cons. 2.1).

[218] GIRSBERGER/VOSER/COLACINO/DONCHI, 1634 and the therein-cited literature and cases.

[219] *DSC 4A_448/2013 of 27 March 2014*, cons. 3.2.2; *DSC 4A_ 362/2013 of 27 March 2014*, cons. 3.2.2; *DSC 4A_150/2012 of 12 July 2012*, cons. 5.2.1; *DSC 4A_481/2010 of 15 March 2011*, cons. 4.

concerned a ban from performing any football activity, which threatened a football player if a request of his previous football club for the payment of a sum due as a result of the termination of his contract with that club was not paid within 90 days. In the Court's view, as an open-ended ban to play football capable of being imposed at the sole decision of a former employer, this measure was excessive contractual limitation of the freedom of the football player and thus contravened Art. 27 (2) CC.

3.3 Domestic and international

a Domestic

Domestic *ordre public* comprises legal principles fundamental for the legal system of a country. The Swiss legislator protects its domestic *ordre public* through Art. 17 PILA and, if we accept that overriding mandatory rules are in fact the positive *ordre public*, also through Art. 18 PILA. Domestic *ordre public* has both procedural and substantive substrate. 196

b International

International *ordre public* encompasses legal principles fundamental to the legal system of any state which is based the rule of law. The Court gives a definition of substantive international *ordre public*: «Ordre public is infringed by the material adjudgment of a disputed claim only when it disregards fundamental legal principles and is, therefore, absolutely irreconcilable with the essential, broadly recognised order of values which, according to the predominant view in Switzerland, should constitute the foundation of every legal order.»[220]. International *ordre public* consists of «clearly fundamental legal principles»[221] and moral values; so fundamental that they make part of any 197

[220] – *4A_558/2011 of 27 March 2012*, cons. 4.1 (corresponding to *DSC 138 III 322,* 327); own translation from German. Also *DSC 4A_414/2010 of 27 October 2010*, cons. 2.1 (the Court does not expressly refer to «international» substantive *ordre public* but this is implied since it examines a claim based on alleged violation of Art. 190 (2) (e) PILA), *Terra armata*, cons. 2.2.1 and *4P.282/2001 of 3 April 2002* (corresponding to *DSC 128 III 191*), cons. 6, b) give examples of international *ordre public*.

[221] MÄCHLER-ERNE/WOLF-METTIER, Art. 17 N 25.

civilised country (though not necessarily of all countries[222]) and the «communauté international des Etats» recognises them as unrenounceable[223].

198 Being so important, the principles to be accounted to international *ordre public* are quite few, i.e. the latter has a narrow scope[224] – not in territorial but in quantitative aspect – as to the number of principles which qualify as its components. For instance, despite its wide and rapid embracement by various legislatures around the world, competition law was not seen by the Court as inherent in every legal system[225]; sanctions imposed by the UN Security Council are also not certain to make part of international *ordre public*[226]. That is also why the case law under the provision which sanctions violations against international *ordre public* – Art. 190 (2) (e) PILA – is very strict[227]: violations of law (even clear ones)[228] such as wrongful application of law or erroneous determination of applicable law[229] or wrong findings of fact (even evidently

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222 Even though some statements leave the impression that international *ordre public* consists of rules that are present in all the states (see e.g. «*...l'ordre public international ... consiste en la combinaison cohérente des systèmes juridiques de l'ensemble des États*» – para 88 of *Cour D'appel Canada Province de Québec Greffe de Montréal, case N°: 500-09-009391-004 (500-05-043881-984), judgment of 31 March 2003*), it comprises rules present only (although these are not few) in those countries considered civilised («A rule does not have to be adopted in all jurisdictions worldwide for it to be considered part of the international public policy» – GIRSBERGER/VOSER/COLACINO/DONCHI, 1379.

223 MÄCHLER-ERNE/WOLF-METTIER, Art. 17 N 25; GIRSBERGER/VOSER/COLACINO/DONCHI, 1379.

224 GIRSBERGER/VOSER/COLACINO/DONCHI, 1379.

225 In *Terra armata*, the Court ruled this with regard to EU and national (i.c. Italian) competition law. EU competition law is a part of the *ordre public* of the EU and thus of the *ordre public* of EU member states (see *Case C-126/97 of 1 June 1999 of CJEU, known as Eco Swiss China Time Ltd v Benetton International NV,* referred to also by the Court in *Terra armata,* cons. 3.1), i.e. it is a part of a domestic *ordre public,* not necessarily of the international *ordre public* as envisaged in Art. 190 (2) (e) (*Terra armata,* cons. 3.1).

226 GIRSBERGER/VOSER/COLACINO/DONCHI, 1399.

227 *DSC 118 II 193*, cons. 6.

228 *DSC 4A_18/2008 of 20 June 2008*, cons. 2.2.

229 *DSC 116 II 634 of 14 November 1990*, cons. 4.

wrong)[230] do not per se qualify as *ordre public* infringements in the meaning of that rule[231].

It is not excluded, and it might even often be so, that international coincides with a national *ordre public*[232]. This is because international *ordre public* is a total of national *ordre publics* (of most, though not all, *ordre publics*). It should be noted that the terminology used for the concept of international *ordre public* is sometimes confusing[233] since the adjectives «transnational», «universal» and «international» are each used, in combination with the term «*ordre public*», to signify an antipode of «domestic *ordre public*» – but they are not synonyms of each other: «transnational» might be understood as something that is valid almost everywhere in the world, i.e. in almost every country («trans-national»); «universal» might be understood as valid everywhere in the world, i.e. universally in every country («univers-al»); and «international» might be understood as valid in relations between countries («inter-national»). 199

c Both

In Switzerland, state courts are solely called upon to watch for the protection of the Swiss *ordre public* within international private law relations. International arbitration courts take care only of international *ordre public*. The rules that apply to state courts and provide for the protection of *ordre public* – Art. 17 PILA (and potentially Art. 18 PILA) – speak of Swiss *ordre public*. The rule which makes sure that *ordre public* is paid tribute to within Swiss international arbitration – Art. 190 (2) (e) PILA – is read as envisaging international *ordre public*. In fact, Art. 190 (2) (e) PILA does not characterise the *ordre public* which it refers to as «international», «transnational» or «universal» explicitly. However, first of all, the Court has ruled that its case law «strived to free the public policy of art. 190 (2) (e) PILA from any national connection, 200

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230 *DSC 116 II 634 of 14 November 1990.*

231 A narrow view of a violation of *ordre public* is witnessed also in other jurisdictions – see e.g. § 1059 of the German Civil Code of Procedure or Sec. 67 and 68 of the English Arbitration Act.

232 MÄCHLER-ERNE/WOLF-METTIER, Art. 17 N 25 and the therein cited authors.

233 – which was admitted also by the Court itself (*Terra armata*, cons. 2.2.2, second paragraph).

whether the lex fori, the lex causae or the law of a third country» and that «the ground of appeal set forth in that provision does not aim at protecting the Swiss legal order»[234]. Second, Art. 190 (2) (e) PILA is read *a contrario* to Art. 17 PILA: since the latter speaks of «Swiss ordre public» and it – of «ordre public» – it must envisage an *ordre public* wider than the Swiss *ordre public* which is an international *ordre public*[235]. Third, it is considered logical that Swiss international arbitration awards comply with international, rather than Swiss, *ordre public* because they «as a rule, are intended for export»[236] (they are usually enforced outside Switzerland), and by making sure that they obey the fundamental principles of most civilised countries around the globe, the chances for export of them (for their enforcement abroad) are raised[237]. One can also add that since the relation of a Swiss international arbitration procedure to Switzerland will be loose (because of the idea of international arbitration as a dispute resolution mechanism as distant as possible from states' laws, including from the seat's law), the Swiss *ordre public* would not be that much touched upon by such procedure, especially if the award is to be enforced abroad (to be «exported»).

201 Apart from Swiss law, international law is also believed to render international rather than domestic *ordre public* relevant for international arbitration: Art. V (2) (b) New York Convention, which contains a ground for a refusal by a party to the Convention to recognise and enforce a foreign arbitral award, is mostly interpreted as envisaging a violation of international *ordre public*[238] (though one cannot help but observe that, as much as it corresponds to the spirit and

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234 *Terra armata*, cons. 2.2.2., fourth paragraph.

235 ZÄCH, 284.

236 ZÄCH, 285.

237 Berti cited in MÄCHLER-ERNE/WOLF-METTIER, Art. 17 N 25; ZÄCH, 284, 285.

238 The description in *World Duty Free Company Limited v The Republic Of Kenya (ICSID ARB/00/7)*, para 138-141 of the practice of seeing the *ordre public* under Art. V (2) (b) New York Convention as international is rather confusing.

ideas of the Convention, this interpretation contradicts far too much the wording of the article – «public policy of *that country*» (emphasis added)[239]).

4. Similarities

Overriding mandatory rules and *ordre public* in fact have common origin – they are both born from the care for public interests. This has made it possible that so far, when a conflict of laws rule regarding such laws has been missing, «the connection of overriding mandatory laws has been addressed within the ordre public reservation»[240] (even if this approach left a part of the overriding mandatory laws unhandled because only a part of them qualify as *ordre public*, since (as will be discussed) despite the common origin, overriding mandatory rules differ from *ordre public*). 202

5. Differentiation

Differences between overriding mandatory rules and *ordre public* have already been considered in Chapter 8. 203

Overriding mandatory rules can be, and frequently are (but do not have to be) part of the *ordre public*[241]. Even when overriding mandatory rules reach the level of *ordre public*, Art. 17 PILA, potentially Art. 18 PILA or Art. 190 (2) 204

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[239] Also, the Court might be accepting that the public policy envisaged in Art. V (2) (b) New York Convention is domestic. In *Terra armata*, cons. 3.1, it asserts that the view of the Court of the European Community that Community competition law belongs to the *ordre public* designed by the New York Convention does not prevent it from concluding that such law does not qualify as *ordre public* under 190 (2) (e) PILA. Consequently, for the Court the *ordre public* under Art. V (2) (b) New York Convention is different than the *ordre public* under 190 (2) (e) PILA. Keeping in mind that according to its case law, the latter is international *ordre public*, the Court apparently accepts that the *ordre public* under Art. V (2) (b) New York Convention is not international *ordre public*, hence, that it is domestic.

[240] SCHNYDER, Wirtschaftskollisionsrecht, 57, first paragraph.

[241] «Well, there are norms of the material law which possess a *qualified* mandatory character, yet do not, without further ado, absolutely fulfil the impetus of ordre public» – SCHNYDER, Eingriffsnormen im Versicherungskollisionsrecht, 620; emphasis in the original text; own translation from German. See also KAUFMANN-KOHLER/RIGOZZI, 7.92.

(e) PILA will apply to them; i.e. of relevance will be their capacity as *ordre public*, and not their capacity as overriding mandatory rules. Then, *ordre public* has a much higher ethical content, and hence smaller content (only few principles are of such high ethical nature) than overriding mandatory rules. The values protected by *ordre public* are more fundamental than those protected by overriding mandatory rules – if the latter seeks to protect principles which keep a legal system «healthy», the former safeguards principles without which there is no legal system (no rule of law) at all. *Ordre public* does not need to be incarnated in a concrete norm of the objective law, whilst an overriding mandatory rule is always a legal provision[242]; that is also why Art. 19 PILA and Art. 9 (1) Rome I speak of «provision» and respectively «provisions»[243].

205 Legal acts distinguish between overriding mandatory rules and *ordre public*. The treatment of overriding mandatory rules in para 1 and 2 of Art. 11 of The Hague Principles on Choice of Law differs from the treatment of public policy in para 3 and 4 respectively. Besides, the title and para 5 of that article mention overriding mandatory rules and public policy separately. Rome I handles overriding mandatory provisions, public policy, mandatory rules and mandatory protective rules in different norms – in Art. 9, in Art. 21, in Art. 3 (3) and (4) and 11 (5) (b) and in Art. 6 (2) and 8 (1) respectively. In Recital 37 of its preamble, the regulation refers to «public policy *and* overriding mandatory rules» (emphasis added). Also, the preamble of Rome II distinguishes public policy from overriding mandatory provisions and from mandatory rules and mandatory protective rules (Recital 32).

206 Because overriding mandatory rules differ from *ordre public*, their violation does not automatically qualify as a violation of the *ordre public* under Art. 190 (2) (e) PILA. That is demonstrated in *Not Indicated v Not Indicated* or in *Terra armata.* In the latter, the Court states that Art. 190 (2) (e) PILA does not sanction «the failure to consider an immediately applicable mandatory provision

242 VOSER, Lois d'application immédiate, 249.

243 See also, with regard to Art. 9 Rome I, LEHMANN, 536.

of a third state»[244]. Also, the majority (despite some, seemingly, other views[245]) in the doctrine consider that the failure of an international arbitral award to observe overriding mandatory rules is not equal to failure to respect *ordre public* – e.g. an arbitrator's incompliance with Art. 19 PILA (i.e., as in the last cited case, incompliance with the overriding mandatory rules of a third state) was not in itself contrary to public policy under Art. 190 (2) (e) PILA[246]. The violation of overriding mandatory rules could qualify as a violation of *ordre public* but only where the overriding mandatory rules infringed have at the same time the character of *ordre public*; and in that case, the concerned violation will be treated as a violation of *ordre public,* and not as one of overriding mandatory rules.

Para 47 of the CJEU's judgment of 17 October 2013 in *Case C-184/12* is confusing. It defines «public order legislation» in an almost identical way to how Rome I defines overriding mandatory rules; it states: «the classification of national provisions by a Member State as public order legislation applies to national provisions compliance with which has been deemed to be so crucial for the protection of the political, social or economic order in the Member State concerned as to require compliance therewith by all persons present on the national territory of that Member State and all legal relationships within that 207

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244 *Terra armata*, cons. 2.2.2., fourth paragraph, *in fine*.

245 See e.g. PFISTERER, Art. 190 N 86. In her view, the missing or wrong application of an overriding mandatory competition law rule can constitute a violation of the *ordre public* when it leads to a decision whose result is contrary to the *ordre public.* It is not clear why the defect of the application of overriding mandatory law should lead to a result that contradicts the *ordre public* – if there is such contradiction, that means that the respective infringed rule is an *ordre public* rule*,* and not an overriding mandatory rule. Then, since one of the rules which he sees as candidates to be applied to the violation of overriding mandatory rules – Art. 190 (2) (e) PILA – deals namely with *ordre public*, also KARRER, BSK IPRG, Art. 187 N 237 must believe that a violation of overriding mandatory rules can constitute a violation of *ordre public*.

246 KAUFMANN-KOHLER/RIGOZZI, 7.101. Again, such a statement apparently rests on a presumption that Art. 19 PILA is binding in international arbitration. The correctness of this will be discussed below, but it is in any case irrelevant for the differentiation between overriding mandatory rules and *ordre public* made here.

State (Arblade and Others, paragraph 30, and Case C-319/06 Commission v Luxembourg [1999] ECR I-4323, paragraph 29)».

5.1 Differentiation of overriding mandatory rules from negative ordre public

208 In a state court procedure, negative *ordre public* is activated only «after» the applicable law has been determined in accordance with the traditional conflict of laws rules (only if he or she knows which this governing law is can a judge conclude that its application would be contradictory to the values of his or her forum), whilst some overriding mandatory rules, in particular the overriding mandatory rules of the forum, are applied «before» the proper law is known[247] – as long as the state court «finds out» about their applicability. This chronology is, in fact, the consequence of another difference – that the reservation clause, which is the negative *ordre public*, serves to hinder an unfair result which could occur upon application of a foreign law, whereas overriding mandatory rules want to assert certain goals at any price[248]. Then, since overriding mandatory rules are amongst the law applied or considered with the aim of resolving the dispute, they are part of the resolution of the dispute, whilst the negative *ordre public* is a limitation to such resolution (and thus to the overriding mandatory rules). Last but not least, as SCHNYDER puts it with regard to economic law, *ordre public* regards the content of a foreign *lex causae* and cannot explain the consideration of the economic overriding mandatory rules of the *lex fori* in the presence of such foreign *lex causae* – this consideration happens independently from such *lex* causae; hence, the *ordre public* (most probably the negative *ordre public* is meant) had to be supplemented by a «positive function» whose mission had been to dogmatise the *lois d'application immédiate*[249].

5.2 Differentiation of overriding mandatory rules from positive ordre public

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[247] Green Paper on the conversion of the Rome Convention, 45.

[248] ARNOLD, 142. Own translation from German.

[249] SCHNYDER, Wirtschaftslkollissionsrecht, 275.

The difference between overriding mandatory rules and positive *ordre public* is much slighter – if it is present at all – than that between overriding mandatory rules and negative *ordre public*.

KARRER[250] and, seemingly, SCHNYDER[251] equate positive *ordre public* with overriding mandatory rules. Indeed, both concepts «act» in the same way – they impose themselves on the law regulating the case. Besides, it was Art. 18 PILA that was considered to contain the positive *ordre public* that the characteristics of overriding mandatory rules were extracted from (see above – Chapter 9, I., 1.1, a.). This article appears to be describing rules rather than an abstract concept – it talks about «provisions» – and such rules cannot be anything but overriding mandatory rules. 210

On the other hand, differences remain. First, being a type of *ordre public*, the positive *ordre public* contains the most important principles, whilst overriding mandatory rules – contain only (though also substantial) important principles. Second, whilst, again owing to its nature as *ordre public*, positive *ordre public* would not necessarily be vested in a rule (it might also be a concept or an idea) overriding mandatory rules would. 211

[250] KARRER, BSK IPRG, Art. 187 N 246.

[251] The author refers to the overriding mandatory rules of the *lex fori* as «the so-called positive ordre public» – SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgericht, 316.

Chapter 12: Method

I. Historically

1. Inapplicability of Savigny's (classical) conflict of laws rules

212 Savigny saw certain laws as incapable of being treated through his method, which consisted of conflict of laws rules determining the applicable law according to the facts of the case (see above – Chapter 7, I.). The free acting across states entailed by this approach was, in his view, irreconcilable with the specific nature of those laws. The laws are namely the overriding mandatory rules.

213 The defining of the borders of those laws excluded by Savigny was probably the most difficult task in the whole doctrine.

2. Francescakis' view on applicability from the law

214 Francescakis made an attempt in the direction of finding these rules that Savigny excluded from his technique; covering, however, only a part of them – those that belong to the state that hosts the legal process without those of the *lex causae* or of a third law. The author created a new term – the nowadays famous «*lois d'application immédiate*»[252]. For him, these *lois* were domestic material norms which, in the name of the protection of the organisation of the state (or of the society of the state – «société étatique»), were to be applied only by virtue of their own will without a conflict of laws rule ordering such applicability, *ergo*, immediately («immédiate»), in fact, even in ignorance of other conflict of law rules potentially ordering the applicability of other substantive laws. The spatial scope of *lois d'application immédiate* resulted directly from their significance for the protection of the organisation of the state.

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[252] As a matter of fact, he wanted to analyse an existing phenomenon but became famous as a founder of a new doctrine.

3. Today's position on special conflict of laws rules

3.1 Not from the law

While acknowledging his contribution in «finding» and managing some of the law to which Savigny's method could not be applied, today's main doctrine is sceptical towards Francescakis' theory. It does not agree that the reason why the rules in question remain outside Savigny's technique is that their applicability does not need to be ordered by conflict of laws rules. The reason was that the conflict of laws rules which were anyway necessary were not those of Savigny. 215

3.2 Overriding mandatory rules needing special conflict law distinct from private international law

The conflict of laws rules needed to address the rules that are unhandled by Savigny's method are not based on the facts of the case, i.e. on the concrete (subjective) relationship (like Savigny's conflict of laws rules), but on the objective rule[253]. The substantive norm is interpreted in order for one to establish whether this norm wants to be applied[254]. In particular the protective goal of the material law content of the rule influences the conflict law decision regarding the rule's applicability[255]. In other words, the conflict law dealing with overriding mandatory rules turns out to be a new, special conflict law. 216

On the example of economic conflict law, SCHNYDER considers that the dependence of the conflict law steering overriding mandatory rules on the material law content of the latter is «qualified» and that it attributes to such conflict law connection a special character[256]. For SCHNYDER, this special character is 217

[253] SCHNYDER,Versicherungsrecht der Schweiz, 611f., VOSER, Lois d'application immédiate, 133 and *passim*.

[254] SCHNYDER, Wirtschaftskollisionsrecht, 56, *in initio*, own translation from German.

[255] For SCHNYDER it is beyond any doubt that the «conflict law of the economic law must address the protection goals of the material law» – SCHNYDER, Wirtschaftskollisionsrecht, 159, own translation from German.

[256] SCHNYDER, Wirtschaftskollisionsrecht, 158 (Summary of the first part), own translation from German.

so significant that a separate economic conflict law system parallel to the conventional private international law – international economic law – arises[257]. In his opinion, since economic (both domestic and foreign) law has the function to ensure at the same time «interindividual» and «macroeconomic» justness, it has to be connected through a new «special» connection different than the private international law connection, i.e. regardless of whether it is covered by the latter[258]. This separate economic conflict law, it is contended, arises on the basis of Art. 18 and 19 PILA[259]. KARRER criticises the fact that in practice it is very difficult to differentiate between «ordinary public law» and overriding mandatory rules.[260] According to him, there is not much support in the first eleven chapters of PILA for the theory that there is a distinct economic conflict law, as Art. 18 and 19 PILA deal with overriding mandatory rules under the heading of positive *ordre public*[261]. For him, there is only an exception from the normal connection rather than a separate conflict law[262]. He also underlines that Art. 187 PILA does not mention any separate economic conflict law.

3.3 The special conflict law – lex specialis of or not at all covered by Savigny's conflict of laws rules

218 The special conflict law on overriding mandatory rules is considered to be a *lex specialis* towards private international law[263]. Further, the traditional doctrine on them accepts that *lois d'application immédiate* are *lex specialis* with respect to the usual bilateral conflict of laws rules, and it can be presumed that this is thought of with regard to the overriding mandatory rules of other laws than the law of the forum as well, i.e. with regard to any overriding mandatory

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257 SCHNYDER, Wirtschaftskollisionsrecht, *passim*.

258 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 318 and SCHNYDER, Wirtschaftskollisionsrecht, 300, 301.

259 – as cited (with further authors) in MÄCHLER-ERNE/WOLF-METTIER, Art. 18 N 6.

260 KARRER, BSK IPRG, Art. 187 N 248.

261 It is here contended that overriding mandatory rules and positive *ordre public* are, at least in theory, separate concepts; see above – Chapter 11., IV., 5.2.

262 KARRER, BSK IPRG, Art. 187 N 246.

263 LEHMANN, 502 apparently has such a starting point.

rules. VOSER denies such a *lex specialis* status of the material[264] *lois d'application immédiate*[265]. According to her, those *lois* were anyway not encompassed by the bilateral conflict of law rules – in her view, the latter dealt mostly with the private (and not public) law dimensions of a relationship and were, thus, conceptually incompetent to cover overriding mandatory rules[266]. Formal *lois d'application immédiate* were, to the contrary, covered by the traditional bilateral conflict of law rules and, thus, a *lex specialis*.

3.4 Dogmatic basis of the method

The dogmatic basis of overriding mandatory rules is the international public law's effects principle, which leads to extraterritorial application of law. 219

The effects principle is a sort of exception of another principle of international public law – the territoriality principle. The latter represents the capability of a state to issue legal acts which are legally enforceable only within the territory in which the state exercises its imperium. 220

The effects principle is the capability of a state to issue legal acts that cover facts which have effects within the territory in which this state exercises its imperium but which take place outside this territory[267]. The use of this capability (which is of this principle) leads to extraterritorial application of a legislation i.e. to the material scope of a legislation exceeding its territorial scope. In fact, extraterritorial application of law is frequent in financial markets law and in economic law in general. Internationalisation and integration of financial markets causes events taking place abroad to have an impact on one's own jurisdiction; for example, the listing of bad quality securities on a stock exchange can have a negative impact on the reputation of the country which is a 221

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264 See in VOSER, Lois d'application immédiate, 198ff. a division of *lois d'application immédiate* into material and formal.

265 VOSER, amongst others, Lois d'application immediate, 289.

266 Also VOSER, Lois d'application immédiate,181.

267 LEHMANN, 112.

seat of that exchange[268], or the disclosure abroad of insider information regarding an issuer whose securities are listed on a domestic stock exchange might be of relevance at home[269]. In the context of these examples, it makes sense to subject events taking place abroad but connected to securities listed on a domestic stock exchange to the law in force at the seat of the latter – see e.g. § 1 (2) of the German Securities Trading Act. The effects principle is useful also because the relevant events might be difficult to localise «into» a particular territory (as it is with events set as criteria by financial markets law).

222 Even if it sounds paradoxical, the territoriality principle and the extraterritoriality application of law resulting from the effects principle are able to «live» together. The territoriality principle is valid for the enforcement of acts but not for the application of law: it prevents state A from employing coercion in the territory of state B in order to enforce a legal act X which it issued, but it does not prevent state A from submitting an event materialised in the territory of such state B to this legal act X. This is a just approach because the occurrence of effects within one's territory should be more crucial than the localisation of the event triggering such effects. Moreover, with the pace of today's globalisation, spatial separation of events and effects becomes more and more usual. In any case, international public law's requirement for the presence of a meaningful connection between the regulating jurisdiction and the regulated facts which will also be present here (e.g. that the law in question applies extraterritorially not to any foreign financial services providers but to those that contract with persons based in the territory in which such law is in force) will bring at least some territorial «flavour» to the extraterritorial application. In addition, there is already an area within private international law – delict law – in which the state having suffered the damaging effects of an event accomplished abroad often regulates those effects.

II. Assessment

223 The fact that the effect of overriding mandatory provisions is determined independently on whether these belong to the law which the traditional conflict

[268] For US, European and German law listing is, indeed, enough – LEHMANN, 120.

[269] LEHMANN, 112.

of laws rules of private international law have appointed as the *lex causae* is a strong argument that such provisions are not subject to private international law. In addition, one can contend that, since private international law is «all about resolving competition between *private* law rules»[270] (being namely «private» international law), it is anyway inapt to solve matters which involve public interests – such as the matter of the effect of overriding mandatory rules.

224 Nevertheless, several other arguments justify the law addressing overriding mandatory rules «remaining» in the private international law's domain. First, the Swiss codification of private international law – PILA – contains conflict of laws rules on overriding mandatory rules (Art. 13, 18 and 19 PILA), and inclusion of norms in the codification of a branch of law speaks quite strongly in favour of the belonging of such norms to that branch of law. Second, that these conflict of laws norms on overriding mandatory rules apply a technique for connecting which differs from the technique employed by the majority of conflict of laws rules of private international law does not mean that they do not make part of the latter – it means only that they are a special part of it. Private international law might treat overriding mandatory rules in a special manner, but it (and not «someone» else) treats them. Third, overriding mandatory rules' impact is an impact on private international law relations, hence, it is logical that the instruments of private international law are employable. Fourth, the fact that imperative concerns are touched upon does not mean that the issue needs to be taken out of private (international) law – if it was so, private law would not have contained any imperative norms, which is not the case. Fifth, even if overriding mandatory rules are theoretically a distinct (from private international law) conflict law, (at least by now) in practice they are handled through private international law instruments. The latter are the only means available, and as a matter of fact, as long as they apply the special approach they are applying, they are not a bad option. All in all, there is no need to address overriding mandatory rules through special treatment outside private international law, but only a need to address them through special treatment inside private international law (to use special elements of the private

[270] SEBASTIANUTTI, International financial law, Part 2, 163; emphasis in the original text.

international law's apparatus when approaching them), and this is indeed done at the moment.

Subpart 2: Treatment

For a state judge, it is relevant whether the overriding mandatory rule he or she is contemplating giving effect to originates from the *lex causae*, the *lex fori* or a third law. Whether this will be relevant also for an international arbitrator will be seen in Part 4 below. Here, the attitude of a state court is considered. This discussion will also form the basis of a comparison in the later analysis of the position of an international arbitrator. 225

Chapter 13: Overriding mandatory rules *legis causae*

I. Uniform connection

1. Definition

226 According to the so-called uniform connection theory, all norms of a law are applied together, and the conflict of laws reference to a *lex causae* connects to a law in its entirety; i.e. amongst others, also to the overriding mandatory rules of such a law. It is one single connection for both the ordinary and the overriding mandatory rules of this law. The overriding mandatory rules here are not applied in an exceptional manner but as any other rules of the *lex causae* are.

227 The uniform connection is easy to apply because it rests on a clear criterion – whether the overriding mandatory rules in question belong to the *lex causae*.

2. Literature

228 The prevailing view in the literature is in favour of the uniform connection[271], with Art. 13 PILA mostly pointed at as a ground. However, there are several voices opposing this view[272].

3. Arguments

3.1 Preservation of effect of overriding mandatory rules of the law that would have been applicable in the absence of a choice of law

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271 See (together with any literature cited there): MÄCHLER-ERNE/WOLF-METTIER, Art. 13 N 24; SCHNYDER, Eingriffsnormen im Versicherungskollisionsrecht, 620; SCHNYDER/LIATOWITSCH, 219; SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 313; KAUFMANN-KOHLER/RIGOZZI, 7.94 (where 7.92 gives a reason to believe that «overriding mandatory rules» are meant by the term «mandatory rules»).

272 VISCHER, ZK IPRG, Art. 19 N 2-5,7; VOSER, Mandatory rules, 339, 340; VOSER, Lois d'application immédiate, 83; literature cited in MÄCHLER-ERNE/WOLF-METTIER, Art. 13 N 24.

The strongest argument against the uniform connection is that automatic application of the overriding mandatory rules of the *lex causae* would allow the parties to choose whose state's interests to serve: when they select the *lex causae* (which they are free to do, and in international arbitration often do) the parties render certain overriding mandatory rules (those of the selected law) applicable and other overriding mandatory rules (those of the law which would have been governing but for such choice of law) inapplicable. However, one can object that inclusion of overriding mandatory rules *legis causae* into the choice of *lex causae* does not mean that the overriding mandatory rules of the law which would have been applicable in the absence of the choice of law have no effect – the application or consideration of the overriding mandatory law of the forum or of a third law is possible, and even obligatory, when the conditions for that are fulfilled regardless of the fact that the overriding mandatory rules of the chosen law are also applied. The inclusion of the overriding mandatory rules *legis causae* into the reference to the *lex causae* is relativised e.g. by Art. 19 PILA – as a result of the latter, a third law's overriding mandatory rules are able to suppress the regulatory law of the *lex causae*[273]. Indeed, their belonging to the *lex causae* would ensure applicability of the overriding mandatory rules of the *lex causae* but not their precedence over the overriding mandatory rules of other laws – the overriding mandatory rules *legis causae* will be applied automatically only as long as they do not come into a conflict with the overriding mandatory rules of another law – in which case the respective rules on competition between overriding mandatory rules of different laws will be consulted.

3.2 The advantages of overriding mandatory rules legis causae towards overriding mandatory rules of other laws would be insignificant

Even if the uniform connecting of the overriding mandatory rules of the *lex causae* would not make it impossible that the overriding mandatory rules of other laws are given effect, it is true that such connecting would lead to certain advantages for the overriding mandatory rules of the *lex causae* in comparison 230

[273] SCHNYDER, Wirtschaftskollisionsrecht, 304.

with the latter overriding mandatory rules. Yet those advantages might be categorised as insignificant and natural. For instance, the overriding mandatory rules *legis causae* will be applicable without there being need to prove that they are connected to the case and that their application is required by legitimate and manifestly preponderant interests of a party, as (in accordance with Art. 19 PILA) there will be need with regard to the overriding mandatory rules of another law. However, first, this is fair because the overriding mandatory rules of the *lex causae* are naturally more connected to the case than the overriding mandatory rules of another law (especially of a third law). They are the correction of the ordinary rules of the *lex causae*, hence, the correction of the rules to which the case is (indisputably) submitted. Then, the overriding mandatory rules *legis causae* would obtain «more» effect than the overriding mandatory rules of a third law, since they would be applied and obligatorily applied, whilst the latter would be considered and not obligatorily considered (but only if the adjudicator decides so – see the words «considered» and «may» in Art. 19 PILA). Again, that would be fair because, as third, the third law is so far from the case that the giving of effect to its overriding mandatory rules, if any, is justified only in a light form.

3.3 Systemic nature of law

231 It is true that because of the private law nature of the dispute, the latter will be submitted mostly to the private law norms of the chosen law; however, not exclusively. With regard to some questions, the dispute might be governed by the chosen law's overriding mandatory rules. What is chosen is the whole legal system concerned, and it is just that «*de facto*» (if this term can be used for a legal process like the application of legal norms) the private law norms of the *lex causae* obtain most effect – because they are needed the most.

232 Law is a system. The components of a system, even if they have distinct functions, cannot be contradictory to nor entirely split from each other. On the contrary, they are meant to function together – they «cannot make it» without each other. Thus, the ordinary private law rules of a law cannot be totally separated from the overriding mandatory rules of that law. The function of the latter is, amongst others, to «correct», i.e. to set a border to the freedom to act under,

the former[274]. *Ergo*, the ordinary rules of the *lex causae* are by default accompanied by the overriding mandatory rules of the *lex causae*[275]. In fact, this observation is enough to tip the scales in favour of the uniform connection: it would just be too much against the idea of law as a system (one of the main ideas of it) to split its ordinary from its overriding mandatory rules.

3.4 Nullité sur choix

There is the argument that parties' choice of law applicable to a contract must be understood as not encompassing a law's overriding mandatory rules, which invalidate such a contract, since the parties could not have intended to conclude a void contract – «*nullité sur choix*», *DSC 102 II 143 of 30 March 1976*[276]. One possible counter-argument is that it cannot be that one «looks after» the parties and «corrects» their behaviour – these are «adults» who should take responsibility for their actions. They were or should have been aware of the effect of the *lex causae*'s overriding mandatory rules when drafting the choice of law clause. In accordance with one of the most fundamental principles of law, persons are presumed to know the law – *ignorantia juris non excusat*. And this is so especially with regard to a law that a person chooses and a law which is of particular importance (overriding mandatory law). 233

4. Potential legal basis – Art. 13 PILA

In EU law, for example, there is no legal basis for the uniform connection – Art. 9 Rome I does not handle overriding mandatory rules *legis causae* at all. In Switzerland, Art. 13 PILA is generally accepted as the legal ground, but there are numerous objections – which is not surprising, as the article's text (in particular the second sentence thereof) is somewhat ambiguous. 234

The order of Art. 13 PILA is that the reference to a foreign law encompasses all rules that in the view of such a law are applicable to the case (Art. 13 PILA, first sentence) and that the application of the rules of such a foreign law which are of «a public law character» is not excluded by virtue of this character of 235

[274] SCHWANDER, Einführung, 535, 536, in particular 536.

[275] SCHWANDER, Einführung, 535, 536.

[276] KARRER, BSK IPRG, Art. 187 N 226.

them (Art. 13 PILA, second sentence). Overriding mandatory rules, even if not always contained in public law acts, are considered to be of «public law character» because they take care of public interests. Hence, overriding mandatory rules are covered by the second sentence of Art. 13 PILA.

4.1 Subject matter

236 Art. 13 PILA defines the scope of «the reference of this Act to a foreign law», i.e. the scope of a foreign *lex causae*. By «foreign law», what is meant is law other than Swiss law – or, keeping in mind that Swiss law is the *lex fori* (the procedure in question takes place in Switzerland), law other than the *lex fori*. Most probably it was considered unnecessary to regulate the scope of the reference to Swiss law because such reference was presumed to be omniferous, this law being the own law of the court.

4.2 The second sentence of Art. 13 PILA

237 According to VOSER, Art. 13 PILA does not incorporate the uniform connection but, through its second sentence, only prevents their public law character from becoming the weightiest factor when determining whether norms of a foreign *lex causae* are included in the reference to it[277]. On a strict viewing, she is right. The text of the second sentence of Art. 13 PILA excludes only this exclusion of the norms of a foreign *lex causae* from the reference to it which is based on these norms' public law character, and not any exclusion, hence, it allows other exclusions, hence, it does not include these norms (at least not automatically). In VOSER's view, the legislator intentionally left a gap in the law with regard to the scope of the reference to the *lex causae*, which had to be closed by doctrine and practice[278].

238 SCHNYDER sees two meanings in the second sentence of Art. 13 PILA: a more restrictive one, which coincides with that seen by VOSER, as a prohibition of the exclusion of a foreign law on the sole basis of the public law character of such a law; and another, which corresponds to the uniform connection, as in-

[277] VOSER, Lois d'application immédiate, 76-79 (in particular 78, 79), 83.

[278] VOSER, Lois d'application immédiate, 76-79, 83 (in particular 78, 79, 83).

voking all regulatory law that originates from the *lex causae* and wants to apply. The second meaning is, in SCHNYDER's view, better – but at the same time, he admits that it represents a systemic breakage for the economic conflict law whose special character did not allow abstract privilege based solely on the private international law's reference. At the end, the author seems to believe (rightly) that whilst economic conflict law should in theory be subjected to the special connection, its submitting under the uniform connection is more «natural».[279]

VOSER's position is in line with the literal text of the second sentence of Art. 13 PILA – this sentence is indeed not firm enough on the inclusion of overriding mandatory rules of the *lex causae* into the reference to such *lex causae*. SCHNYDER's interpretation is more liberal and oriented to a practical solution. 239

4.3 The first sentence of Art. 13 PILA

At the same time, the second sentence of Art. 13 PILA needs to be read in connection to its first sentence. Also KAUFMANN-KOHLER/RIGOZZI invoke the latter to support the applicability of overriding mandatory rules *legis causae* [280]. This sentence stipulates that «all provisions» which a foreign *lex causae* considers applicable to the case are encompassed by the reference to such *lex*. Since «all provisions» cannot but include overriding mandatory rules, this sentence must be ordering namely the inclusion of the overriding mandatory rules of the foreign *lex causae* into the reference to it. KAUFMANN-KOHLER/RIGOZZI even note that such application is «well established»[281]. 240

4.4 The first and second sentence of Art. 13 PILA read together

On the one hand, because the second sentence of Art. 13 PILA is second, its content can be perceived as concretisation of the content of this provision's first sentence and thus as narrowing the latter's wide rule. On the other hand, this second sentence can be perceived as additional explanation of the first 241

[279] SCHNYDER, Wirtschaftskollisionsrecht, 304, own translation from German.

[280] KAUFMANN-KOHLER/RIGOZZI, 7.94. They do not refer expressly to that sentence (solely to the article as a whole), but they reproduce the content of that sentence.

[281] KAUFMANN-KOHLER/RIGOZZI, 7.94.

sentence. That constellation even seems to be more natural because the second sentence appears to be trying solely to underline that the first sentence includes (into the reference to the *lex causae*) rules of a public law character, in order to make sure that the private law character of the dispute does not lead one to exclude such rules from this reference.

II. Special connection

1. Characteristics

242 The special connection is independent of the belongingness of the overriding mandatory rules to the *lex causae*[282], hence, it is different from the connection to such *lex causae* – the private international law connection – and that is why it is special. Overriding mandatory rules will not remain unapplied simply because they do not make part of the law of the contract and, on the other hand, they will not automatically be applied because they make part of that law. Privilege of economic overriding mandatory rules of the *lex causae* towards the overriding mandatory rules of a third law is excluded by the special character of the connection. The concept of the special connection is that all overriding mandatory rules, i.e. also the overriding mandatory rules of the *lex cause*, are connected specially and are, hence, equal to each other, with the exception of the overriding mandatory rules of the *lex fori*, which by virtue of Art. 18 PILA enjoy a preferential treatment[283]. From the point of view of the special connection, the overriding mandatory rules *legis causae* are situated outside the borders of the *lex causae*, in some «community» of overriding mandatory law together with the overriding mandatory rules of other laws.

243 To be applied via the special connection, the overriding mandatory rules *legis causae* need to be connected to the facts of the case – an objective connection which also does not depend on the *lex causae*, including on whether the latter

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[282] SCHNYDER, Wirtschaftskollionsrecht, 158 (Summary of the first part).

[283] VISCHER, ZK IPRG, Art. 19 N 3 also excludes the overriding mandatory rules of the forum from the equal treatment of the different overriding mandatory rules he proposes.

is the result of a parties' choice or of the application of a conflict of laws rule[284].

2. Literature

VISCHER believes that overriding mandatory rules *legis causae* are not automatically included in the reference to a foreign law but, where this is so, are applicable because their own scope of application wants this; and that it corresponds more to the specific nature of overriding mandatory rules if all of them, with the exception of those of the forum (Art. 18 PILA), are treated as equally footed under the conditions of Art. 19 PILA[285]. MORSCHER also supports a special connection[286]. VOSER advocates for treating the overriding mandatory rules *legis causae* and the overriding mandatory rules of a third law equally, without granting preferential treatment to the former[287]. Also, for SCHNYDER, the connection in economic conflict law is objective; a choice of law by the parties is irrelevant[288]. In Germany, LEHMANN – who sees it as the connection being expressed in Art. 9 Rome I – appeals for the special connection also for the area of financial markets laws[289]. 244

3. Arguments

3.1 Regulation of private law disputes

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284 SCHNYDER, Wirtschaftskollisionsrecht, 337 (last paragraph thereof).

285 VISCHER, ZK IPRG, Art. 19 N 2 et seqq.

286 MORSCHER, 101, 102.

287 VOSER, Lois d'application immédiate, 79.

288 SCHNYDER, Versicherungsrecht der Schweiz, 612. See also SCHNYDER, Wirtschaftskollisionsrecht, *passim,* e.g. 301, 158 (Summary of the first part). Admittedly, it was mentioned above in Chapter 13, I., 4.2 that this author seems to believe that it is more practical for one to read the alternative of this special connection – the uniform connection – in Art. 13 PILA, but, as underlined there, he seems to see the special connection as more correct from a doctrinal point of view (e.g. SCHNYDER, Wirtschaftskollisionsrecht, 304, *in fine*).

289 LEHMANN, 528-530.

The disputes adjudged under PILA (especially those under Chapter 12 thereof) are private law disputes; hence, one could think that it is only «the business» of the private law part of the *lex causae* to tackle their resolution. In addition, where they have chosen this *lex*, the parties might have had in mind solely this private law part of the *lex causae*. Moreover, parties – especially those that resort to international arbitration – often choose a neutral, i.e. not connected to the relationship, law and a relation of the overriding mandatory rules of such a neutral law to the case is difficult to see.[290]

3.2 Hindering the evasion of overriding mandatory rules of a law that would have been applicable in the absence of a choice of law

246 Owing to the parties' freedom to choose a governing law, the application of overriding mandatory rules of such a governing law by the mere reason of their belonging to that law would allow such parties to avoid the overriding mandatory rules of the law which would have been applicable in the absence of such a choice simply by choosing a law different than the latter. This situation is inadmissible[291]. A means of preventing it is to connect the overriding mandatory rules of the governing law through the special connection which does not depend at all on this belonging of those rules to the chosen law.

3.3 Nullité sur choix

247 Another argument in the cases where the *lex causae* is selected by the parties is that, because the latter could not have intended to choose a law under which their contract would be void, at least those of the overriding mandatory rules of that law which invalidate the contract should not be included in the parties' choice («*nullité sur choix*», *DSC 102 II 143 of 30 March 1976*)[292].

3.4 Special character of overriding mandatory rules

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[290] See also SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 313, 318. There the author refers to a *lex causae* which coincides with the *lex arbitri* – both are Swiss law – but this coincidence is not relevant for the argumentation here.

[291] Also according to SCHNYDER, Wirtschaftskollisionsrecht, 301, *in fine* it cannot be left to the parties to decide on the applicability of regulatory law.

[292] KARRER, BSK IPRG, Art. 187 N 226.

For the overriding mandatory rules of the *lex causae*, the special connection appears logical. In order for them to be able to override other rules (and thus namely be «overriding») they must be connected in some special manner. 248

4. Potential legal basis – Art. 19 PILA

If overriding mandatory rules of the *lex causae* are to be connected as if they were overriding mandatory rules of a third law, the first idea that comes to mind is to base (directly or indirectly) their application on Art. 19 PILA – this is the provision dealing with overriding mandatory rules of a third law. VOSER suggests that the legislative gap which she sees with regard to these overriding mandatory rules of the *lex causae* be filled through application by analogy of the criteria of Art. 19 PILA[293]. Also, VISCHER seems to be applying Art. 19 PILA by analogy – as already mentioned, he applies the requisites of the latter (not the latter itself but its requisites, which namely resembles application by analogy)[294]. MORSCHER sees even a direct application of Art. 19 PILA to the *lex causae'*s overriding mandatory rules[295]. For MORSCHER, an overriding mandatory rule which is a part of the *lex causae* but is not encompassed by the conflict of law rule's reference to the *lex causae* constituted «a provision of another law which claims to be mandatorily applied» and the *lex causae* – «the law designated by this Act» – within the meaning of Art. 19 (1) PILA. This view for application of Art. 19 PILA to the overriding mandatory rules *legis causae* is not supported here. That Art. 13 PILA does not provide for automatic inclusion of law of a public law character into the reference to the *lex causae* does not mean that there cannot be non-automatic inclusion, and in that case the *lex causae*'s rules of public law character will not be able to qualify as provisions of a law other than the law designated by PILA, as contended by MORSCHER – they will make part of such designated law. Also, VOSER – who denies inclusion by Art. 13 PILA of the overriding mandatory rules of the *lex causae* into the reference to the latter – does not go so far as to apply Art. 19 249

[293] VOSER, Lois d'application immediate, 79-84.

[294] VISCHER, ZK IPRG, Art. 19 N 2 et seqq, in particular N 3.

[295] MORSCHER, 101, 102.

PILA directly; she applies it by analogy[296]. All in all, the legal basis of the special connection can at best be construed by analogy.

250 Then, if Art. 19 PILA is applied to the overriding mandatory rules *legis causae*, all the criteria of this provision will need to be met. In addition, the end effect will be only the consideration of such overriding mandatory rules («considered» – Art. 19 PILA), and not their application as in the case of uniform connecting. What is more, this effect will not be certain like that of the uniform connection – it will depend on the discretion of the adjudicator (Art. 19 PILA uses the verb «may» while Art. 13 PILA uses imperative language).

III. Opting for the uniform connection

It is true that the uniform connection is unable to explain how come it connects rules, which by nature are to be connected independently on their belongingness to the *lex causae*, on the basis of such belongingess. However, the preservation of the systemic nature of the *lex causae*, and in particular the giving of the opportunity to the overriding mandatory rules of the *lex causae* to place borders to the ordinary rules of the *lex causae*, which is achieved through such uniform connection, is here perceived as more vital than the described logical problem – the latter is not underestimated, even less so denied, but a priority is set in the face of the need to make a (difficult) balancing; the less bad solution is opted for. Besides, it is easier from a practical point of view to effectuate the uniform connection than the special connection. First, it at least has some, even if not unambiguous, legal basis – Art. 13 PILA – whereas the special connection lacks such and needs to be applied through *analogia legis* with Art. 19 PILA; second, the criterion used is quite simple – whether the overriding mandatory rules in question belong to the *lex causae* or not – whilst the criteria of Art. 19 PILA are far more numerous and (mostly because of their subjectivity) complex; third, employing the uniform connection would be in accordance with law's principle of economy, since the judge would take a connection that he or she had already established (through the traditional conflict of laws rules). 251

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[296] VOSER, Lois d'application immédiate, 84.

One could try to employ some compromise between the uniform and special connection. For instance, one might consider, rather than apply, the overriding mandatory rules of the *lex causae*. This way the overriding mandatory rules of the *lex causae* would be given some effect, through which the unity between them and the private law norms of the *lex causae* would be kept, and at the same time this effect would be less strong than the effect given to the ordinary private law rules of the *lex causae*, which would mean conforming with the idea that overriding mandatory rules are special, different than the rules connected through the designation of the *lex causae* and with the idea that a private law dispute should be governed only by private law rules. Nevertheless, such construction is too unstable. The mere consideration of the overriding mandatory rules of the *lex causae* would not be sufficient to serve the functioning of the norms of the *lex causae* as one single system. All in all, the uniform connection seems to be the more convenient option.

Chapter 14: Overriding mandatory rules *legis fori*

I. Term

253 Here «overriding mandatory rules of the *lex fori*», «overriding mandatory rules *legis fori*», «overriding mandatory rules of the forum», «overriding mandatory rules of the seat» and similar will envisage overriding mandatory rules of such *lex fori* which is not at the same time a uniformly connected *lex causae*. In the latter situation, the overriding mandatory rules in question will become applicable by virtue of their belongingness to the uniformly connected *lex causae*, and this will not allow one to make the intended examination – namely whether the belongingness of overriding mandatory rules to the *lex fori* is able to provoke their applicability.[297]

II. Preferential connection

1. Characteristics

254 For state courts, there are three categories – overriding mandatory rules *legis causae*, overriding mandatory rules *legis fori* and overriding mandatory rules of a third law.The overriding mandatory rules of the *lex fori* are treated differently than the overriding mandatory rules of the *lex causae* and the overriding mandatory rules of a law which is neither the *lex causae* nor the *lex fori*, i.e. which is a «third» law: they are governed by a separate rule (Art. 18 PILA[298]) and this separate rule does not make it relevant whether they belong to the *lex causae* or not.

255 A difference between the treatment of the overriding mandatory rules of the *lex fori* and the treatment of the overriding mandatory rules of the *lex causae*

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297 The simultaneous qualification of the *lex fori* as a *lex causae* would not disturb the current analysis where such *lex causae* is not connected to uniformly, since in this case its overriding mandatory rules are deemed to be outside such *lex causae*.

298 Also, Rome I uses separate provisions, for example, for the overriding mandatory rules of the forum and the overriding mandatory rules of a third law – respectively Art. 9 (2) and Art. 9 (3) Rome I.

is that the former attain applicability also when they do not belong to the governing law. The distinction between the addressing of overriding mandatory rules of the *lex fori* and overriding mandatory rules of a third law is, first, that the overriding mandatory rules *legis fori* are applied not only in the presence of legitimate and manifest preponderant interests of a party requiring that and a connection of those rules to the case (actually such connection is reckoned to be there because the rules make part of the law of the state in which the adjudication over the case takes place) but in any circumstances and, second, that the overriding mandatory rules *legis fori* will be applied, not merely considered.[299]

On the one hand, in private international law cases, state courts are allowed (and where the conditions for that are met, are obliged) to resolve the substance according to a law other than the law of the forum, i.e. difference in the identity of the bearer of the competence to adjudicate and the bearer of the competence to regulate is permissible. On the other hand, a state judge has a duty to protect the legal order of the bearer of adjudicating competence because they adjudicate in its name. According to SCHNYDER, it is unclarified whether state courts can turn only to a foreign law whose content is largely equivalent to the *lex fori* or to any foreign law that does not violate the *ordre public* of the forum[300]. Here the first option is considered too restrictive and lacking a legal basis, and the second option is considered the better one, since it can be rested on Art. 17 PILA – although, due to the order of Art. 18 PILA, it needs to be supplemented by the requirement that no overriding mandatory rules of the *lex fori* are violated. 256

All in all, with regard to the overriding mandatory rules of the *lex fori*, one can say that they are treated preferentially – their connection can be called a «preferential connection». 257

2. Legal basis – Art. 18 PILA

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[299] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 316.

[300] SCHNYDER, EC International Insurance Contract Law, 594.

It became clear also above that Art. 18 PILA is the one that gives precedence to the overriding mandatory rules of the *lex fori* over foreign (ordinary and overriding mandatory) law[301].

[301] SCHNYDER, IPR der Leistungsstörungen, 214.

Chapter 15: Overriding mandatory rules of a third law

259 In Switzerland, the question on the application or consideration of overriding mandatory rules of a third law is the main question, with that on the effect of overriding mandatory rules *legis causae* being, if not solved, at least dominated by one opinion – that in favour of the uniform connection based on Art. 13 PILA.

I. Term

260 «Third law» in the case of a (private international law) state court procedure means a law which is neither the *lex causae* nor the *lex fori*. For international arbitration courts (as will be seen in detail later below), it means a law that is not the *lex causae*.

II. Special connection

1. Characteristics

261 In the current system of internationalised economies, one cannot afford oneself a full disregard of the interests of a third state in having its law applied or considered even if such law is namely a third law. These interests shall be relevant on a conflict of laws level – in particular, general and special rules on a special connection shall address them.[302]

262 The special connection is the only option for the overriding mandatory rules of a third law. Those cannot be addressed through a uniform connection because the latter is a connection of the *lex causae* – it connects only the latter.

263 That special connection will be the same as the one through which overriding mandatory rules *legis causae* were addressed under one of the theories regarding their treatment discussed above – see Chapter 13, II. This connection does not take into account the belonging of the respective overriding mandatory

[302] SCHNYDER, Wirtschaftskollisionsrecht, 166.

rules to the *lex causae* – here there is no belonging – but resorts to its own criteria (contained in Art. 19 PILA).

2. Legal basis – Art. 19 PILA

264 Art. 19 PILA enjoys rather narrow application due to the numerous and strict conditions it imposes. The Court has reiterated that this provision is to be applied as an exception. For instance, in its view, application should not take place when Swiss law itself already observes the interests pursued by the foreign legislation and makes available means for their protection.[303]

2.1 Comparison with Art. 9 (3) Rome I

265 Whilst, as established above, Art. 19 PILA followed the principle of the relevant EU provision (at the time Art. 7 (1) Rome Convention, today Art. 9 (3) Rome I) when it indirectly described the characteristics of overriding mandatory rules, it approached the criteria for the connection of the overriding mandatory rules of a third law differently[304]. It has a narrower field of application than Art. 9 (3) Rome I in as much as it (in particular, its German and Italian translation) requires that legitimate interests of the parties are affected in order that it is applied[305], and in as much as it provides for the taking as a starting point a Swiss concept of law[306]. For the rest, and with regard to the effect given (to the third law's overriding mandatory rules), however, Art. 19 PILA is wider than Art. 9 (3) Rome I. It gives effect to a greater number of overriding mandatory rules of third laws – namely to any overriding mandatory rules of any third law (Art. 9 (3) Rome I gives effect not to the overriding mandatory rules of any third law, but only to the overriding mandatory rules of the law of the country in which the contract is to be performed, and not to any overriding

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303 Amongst others, *4C.332/2003 of 7 May 2004* cons. 3.5.1 and 3.5.2 (corresponding to *DSC 130 III 620, 630 and 631*).

304 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315.

305 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315.

306 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315.

mandatory rules of such law, but only to those of them that render such contract unlawful[307]). This narrow scope of Art. 9 (3) Rome I is often criticised[308]. Indeed, it is not clear why only the overriding mandatory rules of the place of performance are given effect[309]. Also, the requirement that the overriding mandatory rules in question render the performance unlawful might be burdensome, especially in the case of financial markets overriding mandatory rules (these meet it rarely)[310]. Art. 19 PILA has actually been given as an example which can be followed in case of an EU law reform seeking to extend the scope of Art. 9 (3) Rome I[311].

2.2 Subject matter

There are different «readings» of the subject matter of Art. 19 PILA. Some see it as envisaging an overriding mandatory rule of a law different than the *lex* 266

[307] The narrowness of the possibility to consider a third law's overriding mandatory rules was confirmed in the CJEU's judgement *Case C-135/15 of 18 October 2016*. In this judgment, CJEU rejected any opportunity that overriding mandatory rules of a law which is not *lex causae* or *lex fori* or the law of the place of contract's performance be considered by virtue of Art. 9 Rome I. In order to reach this conclusion – namely that the list of the overriding mandatory rules to be considered under Art. 9 Rome I is exhaustive (para 49 of the judgement) – the court observed that, in accordance with Recital 37 Rome I, the consideration of overriding mandatory rules of a third law is to take account of «public interest in exceptional circumstances» (para 43), that Art. 9 Rome I should be interpreted strictly because it is a «derogating measure» (para 44) and that a referral to overriding mandatory rules of third laws other than those indicated in Art. 9 (2) and (3) Rome I would impair the legal certainty (para 46). At the same time, the court left open the possibility that the overriding mandatory rules not handled under Art. 9 Rome I are considered as facts within the application of the *lex causae* where the latter has a substantive rule ordering this (material law approach) – such proceeding fell outside the scope of Rome I, the latter dealing solely with conflict of law problems, but not with substantive solutions of the *lex causae* (para 51 and 52).

[308] See LEHMANN, who even calls for a reform, and SCHNYDER, Eingriffsnormen im Versicherungskollisionsrecht, 622. In fact, LEHMANN, 545 criticises that Rome I gives too limited effect to all overriding mandatory rules, not only to the third law's overriding mandatory rules.

[309] See also SCHNYDER, Eingriffsnormen im Versicherungskollisionsrecht, 622.

[310] LEHMANN, 535.

[311] LEHMANN, 545.

fori. For VISCHER, it deals with overriding mandatory rules not belonging to the *lex causae*[312] [313]. A third opinion is that Art. 19 PILA refers to a rule which originates neither from the *lex fori* nor from the *lex causae*. Here, the latter theory is supported. The adjective «foreign» in the title specifies that Art. 19 PILA deals with a law other than Swiss law, or, keeping in mind that the latter is the *lex fori* (Art. 19 PILA regulates legal procedures which take place in Switzerland since the whole PILA regulates such procedures), a law other than the *lex fori*. The expression «instead of the law that is designated by this Act» in Art. 19 PILA narrows down further this foreign law (this law other than the *lex fori*) to that which is not the *lex causa*e (a law «designated» by PILA cannot mean other than a law to which PILA has granted some function which is namely the already mentioned *lex fori* but also the *lex causae*). In addition, Art. 19 PILA covering a law that is neither the *lex fori* nor the *lex causae* is the only possibility if one, as here, accepts the uniform connection theory – within the latter the overriding mandatory rules of the *lex causae* represent a law «designated by this Act» whilst Art. 19 PILA handles a law which is not «designated by this Act»[314].

2.3 Requirements

267 The conditions for the application of Art. 19 PILA are not uncontroversial.

a Connection

268 In order to attain consideration, the third overriding mandatory law in question should be connected to the facts of the case. This is an objective criterion which, as SCHNYDER puts it, constitutes a «first filter» for disallowing unjustified interferences with the *lex causae*[315]. The applicability of the law of an

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[312] This is clear from VISCHER, ZK IPRG, Art. 19 N 18.

[313] That might at the first sight appear odd because VISCHER applied Art. 19 PILA in relation to overriding mandatory rules of the *lex causae* – see Chapter 13, II., 2. However, he applied it only by analogy – he applied only its conditions, not Art. 19 itself (see again Chapter 13, II., 2.).

[314] See also MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 13.

[315] SCHNYDER, Wirtschaftskollisionsrecht, 337.

overriding mandatory rule to a party participating in the transaction would not represent a sufficient connection[316], but the latter would be present, for example, where the *lex fori* would have claimed applicability in a comparable situation[317].

b «That wants to apply mandatorily»

In order to be subsumed under Art. 19 PILA, a rule needs to want itself to be applied mandatorily. Such willingness is one of the components of an overriding mandatory rule; see above – Chapter 9, V. 269

c «Interests of a party so require»

That the interests of a party require the consideration of the third law's overriding mandatory rule means that the legal situation of such a party would improve or at least would be less rigorous if that rule is considered. 270

d «Legitimate and manifestly preponderant interests»

Art. 19 PILA refers to interests that are «legitimate», which is interests that deserve to be protected by the legal system – *bona fide* interests – to the exclusion, for example, of interests in circumventing a law (no one can benefit from their own illegal behaviour). The interests concerned need to be also «manifestly preponderant». 271

e Interests «of a party»

The different language versions of Art. 19 PILA are inconsistent: its German and Italian version refers to «interests of a party» («Interessen einer Partei» in German, «interessi … di una parte» in Italian) whilst the French version refers solely to «interests» («des intérêts») without identifying the bearer of these. That constellation renders it unclear whether only interests of a party or any interests (i.e. also interests e.g. of a state) constitute a criterion. Art. 19 PILA should be amended in order that its translations are harmonised and clarity is 272

316 SCHNYDER, Wirtschaftskollisionsrecht, 337, including fn. 184 which cites a case.

317 SCHNYDER, Wirtschaftskollisionsrecht, 337, third paragraph and the references there.

brought in this regard: either the words «of a party» («einer Partei», respectively «di una parte») can be removed from its German and Italian versions or the words «of a party» («d'une partie») can be added after the word «prépondérants» in its French version.

273 On the one hand, there are objections against the condition in the German and Italian text that the interests that should require the consideration of the overriding mandatory rule should be those of a party. It is said that the consideration of a rule protecting public interests, such as an overriding mandatory rule, cannot be made dependent on private interests like the interests of a party to the dispute.

274 On the other hand, one can see the point of such criterion due to the following.

275 First, the overriding mandatory rule in question is a rule of a third law, i.e. not of a law that is principally applicable. The condition that a party is interested in the consideration of the third law's overriding mandatory rule might be a fair compromise between the need to protect the public interests which are the subject matter of the respective third law's overriding mandatory rule and the need to stay as close as possible to the usual manner in which private law disputes are resolved – through application of the *lex causae*, and not of other laws.

276 Second, the reference to the interests of a party corresponds to the main mission of private international law, and thus of PILA – to regulate private legal relationships[318], i.e. to make justice for private parties. The adjudicator under PILA is not an enforcer of the interests of public parties, such as states; he or she might be so only as an exception.

277 Third, sometimes the third law's overriding mandatory rule might serve «selfish»[319] ambitions of the third state, e.g. those of a purely political nature, which one might not want to validate. The requirement that a third law's overriding mandatory rule concerns the legitimate interests of a party in order to be con-

[318] See also VOSER, Lois d'application immédiate, 70, 71.

[319] See also VISCHER, Schwerpunkte, 122.

sidered prevents such validating, since consideration of such a «selfish» overriding mandatory rule would not be of a party's legitimate interest and hence would not be proceeded to. On the other hand, the requirement that the party's interests in question are «legitimate» prevents the conferral of exaggerated attention on individual interests. For instance, an interest of a party in the circumvention of rules *legis causae* through the consideration of a third law's overriding mandatory rules will not be legitimate.

Last but not least, conferring attention on the interests of the parties is not necessarily equal to ignoring the interests of the state author of the overriding mandatory rules; it can even at the same time mean respecting the latter. For instance, when a party is released from a contractual obligation which it is prohibited by an overriding mandatory rule from entering into, not only the interests of this party (in not being sanctioned for incompliance with a contract) but also the interests of the state having issued the overriding mandatory rule (in seeing the prohibition being enforced) are protected. SCHNYDER is of the same opinion[320], but he sees a difference where the interests of the party that wants the foreign overriding mandatory rule not to be applied prevail. It is believed here that this should not be a problematic situation because for a third law's overriding mandatory rule to be considered under Art. 19 PILA it suffices that the interests of a party require such consideration – they do not need also to prevail over the interests of the counterparty that wants the foreign overriding mandatory rule not to be considered (there will be consideration even if the latter interests prevail). 278

2.4 Power conferred

a «May»

Like Art. 9 (3) Rome I, Art. 19 PILA anchors only a right but not an obligation. It reads «*may* be considered» (emphasis added). 279

b «Consider»

[320] See also SCHNYDER, Wirtschaftskollisionsrecht, 255, *in fine*.

280 Both in the title and in the text[321] of Art. 19 PILA, the Swiss legislature uses the concept of «considering» instead of the classical «applying».[322]

281 There are opinions that «consideration» and «application» are the same in their core, in particular that consideration is «selective «application»» which «sounds friendlier»[323]. Indeed, one may contend that a rule is either applied or not, and anything in the middle does not exist or is at least a confusing half-solution, so that consideration coincides with application.

282 Nevertheless, it is here believed that a middle ground might be possible. It would exist where solely some of the legal consequences envisaged by the overriding mandatory rule (e.g. unenforceability but not nullity) or different

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[321] In their original German text, both the first and the second paragraph of Art. 19 PILA talk about consideration, rather than application. The first paragraph is usually translated into English accordingly but the second paragraph is often not, with words such as «applied», «applicable» or «to apply» being used (see e.g. KAUFMANN-KOHLER/RIGOZZI, 7.99).

[322] Also Art. 9 (3) Rome I does not order the application of the overriding mandatory rules of a third law but the giving of effect to them, which might encompass both application or consideration, thus being wider than just consideration. Accepting that giving of effect to a rule is not necessarily equal to applying it would be compatible with the theory that Art. 9 (3) Rome I was based on the English case *Ralli Brothers*. In that case the judges did not apply, i.e. enforce, the overriding mandatory of the third law but gave effect to it – they did not declare the concerned contract null but only left it unenforced. Also BRIGGS, 203, fn. 56 gives that case as an example of something different than enforcement of non-English law – he gives it as an example of recognition of a non-English law (in the context, the author is making a clarification that the «revenue rule» – the prohibition on English courts to enforce a non-English penal or revenue rule – covers only the enforcement (direct and indirect), but not the recognition, of such non-English penal or revenue rule).
One can note that in its second sentence, Art. 9 (3) Rome I orders that one of the criteria for deciding whether to proceed to the giving of effect of the third law's overriding mandatory rule should be the consequences of the «application or non-application» of such a rule – which is unexplainable because one is ordered to take into account the consequences of something (application) different than that which one is contemplating doing (giving effect); however, this seems to be rather unintentional inaccuracy.

[323] KARRER, BSK IPRG, Art. 187 N 287 with references.

consequences than those foreseen by the overriding mandatory rule (e.g. modification of the contract instead of nullity) are applied.

Then, whilst «application» is a term with an established meaning in private international law doctrine and practice – it is known which adjudicators' actions it includes – «consideration» has only its general meaning as «taking into account». Application is a strictly predetermined process which consists of the strict drawing of all consequences envisaged by an overriding mandatory rule, whilst consideration is more flexible – it comprises the giving of effect only to some of the consequences attached to the overriding mandatory rule. Also, for KAUFMANN-KOHLER/RIGOZZI, an arbitral tribunal which considers the overriding mandatory rule has «a broad freedom in choosing how to implement the mandatory rule. For instance, where the foreign rule provides for the nullity of the contract, it may limit itself to modifying the contractual obligations»[324]. 283

Consideration allows that due regard is taken of the concrete case and that the different interests involved are balanced against each other. For the arbitral tribunal in *ICC Case No. 8528*[325], for example, the consideration provided for in Art. 19 PILA is a call for the adjudicator to make such a balance: «It is the arbitrators [sic] duty to see how to harmonize the agreement, the lex causae and the Turkish law. This duty of harmonization is expressed by the words 'to take into account' contained in Art. 19 PILA. Thus the arbitrators are not compelled to strictly apply the Turkish law but to find a reasonable solution.»[326]. In fact, the balancing of the interests involved – which is possible within the consideration as understood here – fits international cases very well because in the latter both public and private interests are affected, and moreover deeply mingled, so that it would be unfair to serve only the ones or the others of them. 284

Next and very importantly, if «to consider» was the same as «to apply», the Swiss legislator would have simply used the latter concept, as it did in Art. 44, 48-49, 52-55, 61, 65c, 68-69, 72, 82-83, 90-95, 99-107, 108c, 110, 116-126, 285

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[324] KAUFMANN-KOHLER/RIGOZZI, 7.99.

[325] The issue of application by analogy of Art. 19 PILA is mostly dealt with in para 25-39.

[326] Para 32.

128, 132-142, 149c, 154-155, 187 of PILA with regard to the *lex causae*. It is a legislative technique to use one and the same term for the same concept throughout an entire legal act – the aim to prevent ambiguous interpretations of a law prevails over linguistic considerations of avoiding repetitions.

286 An understanding of the law's «consideration» under Art. 19 PILA as something different than a law's «application» is not precluded by the fact that the title of the section – Sec. 3 – in which Art. 19 PILA is situated refers to «applicable law» and with this to the concept of application. As explained in Chapter 6, I., the expression «applicable law» has a wide sense of law which in any manner, not necessarily through being applied, influences the decision regarding the substance of the case.

287 Next, it is logical that a legislator would want to give less intensive effect to rules which do not belong to the *lex causae* than to rules which do. The *lex causae* is namely the law commissioned with the task of governing the case – the governing law: one wants to make as few compromises with this commission as possible.

Chapter 16: Competition between the overriding mandatory rules of the different laws

There is no rule whatsoever on a conflict between the overriding mandatory rules of different laws. 288

I. Competition between overriding mandatory rules *legis causae* and overriding mandatory rules of a third law

Under the uniform connection, overriding mandatory rules *legis causae* obtain effect automatically by virtue of their origin, and they will be applied, not only considered, whereas under Art. 19 PILA, the overriding mandatory rules of a third law will not be given effect automatically – and when they are, they will only be considered, not applied, from which one can conclude that within a conflict between overriding mandatory rules of the *lex causae* and overriding mandatory rules of a third law, the former will have a greater chance to «survive». However, the outcome of this competition should not be predetermined, i.e. the third law's overriding mandatory rules should be left the opportunity to be considered also where overriding mandatory rules of the *lex causae* are applied. Otherwise the application of Art. 19 PILA would be limited. Besides, the latter article does not mention that it would not be applicable where next to the third law's overriding mandatory rule an overriding mandatory rule of the *lex causae* is applicable. SCHNYDER also seems to believe that the consideration of the overriding mandatory rules of a third law is capable of suppressing to some extent the application of the overriding mandatory rules of the *lex causae* because he defines the cumulation between the uniform connecting of the overriding mandatory rules of the *lex causae* and the special connecting of the overriding mandatory rules of a third law, which (cumulation) he sees in 289

PILA, as «attenuated», amongst others, due to this possibility that the overriding mandatory rules of a third law suppress the regulatory law of the *lex causae*[327].

290 The conflict between overriding mandatory rules *legis causae* and overriding mandatory rules of a third law can be solved in the same way as a conflict between the overriding mandatory rules of one third law and the overriding mandatory rules of another third law is solved, whilst one puts up with the probability that the overriding mandatory rules of the *lex causae* obtain greater effect than the overriding mandatory rules of the third law due to the former, as mentioned above, being automatically applicable and namely applicable rather than only to be considered.

II. Competition between overriding mandatory rules *legis fori* and overriding mandatory rules of a third law

[327] SCHNYDER, Wirtschaftskollisionsrecht, 304. However, it is here believed that the possibility that the effect of the overriding mandatory rules *legis causae* is limited through a third law's overriding mandatory rules being considered does not cause the cumulation of the uniform and the special connection to become «attenuated» – because this possibility is inherent in the cumulation anyway, i.e. it exists in the case of any, not only of «attenuated», cumulation – since under the uniform connection the overriding mandatory rules contained in the *lex causae* constitute an integral part of the *lex causae*, everything, including specially connected overriding mandatory rules of a third law, that is capable of limiting the legal effect of such *lex causae* is capable of limiting the legal effect of these overriding mandatory rules contained in the *lex causae*.
The other reason for which SCHNYDER believes that the cumulation between the uniform and the special connection is «attenuated» is that (even if invoked regardless of their content) the overriding mandatory rules of the *lex causae* could be self-limited since Art. 13 PILA (first sentence) referred to the application only of those norms of the *lex causae* which were considered by such *lex causae* applicable (SCHNYDER, Wirtschaftskollisionsrecht, 247, including *inter alia* fn. 26). However, here no self-limitation is seen in this fact – the fact that only those overriding mandatory rules of the *lex causae* which the *lex causae* considers applicable are applied – since anyway every rule is applicable only when the law to which it belongs reckons it applicable; in other words, that is the application itself, and not some self-limitation.

Thanks to Art. 18 PILA, overriding mandatory rules *legis fori* would override the overriding mandatory rules of a third law. This article orders the application of overriding mandatory rules *legis fori* under any circumstances (its wording is firm – «reserved remain»), which is different than Art. 19 PILA's granting of (anyway solely) a right (anyway merely) to consider the overriding mandatory rules of a third law only upon the fulfilment of certain (in fact, quite a few) conditions. 291

A state court would not control the content of a domestic law which it imposes over the *lex causae*, as it would do with the content of a non-domestic law seeking to interfere with the latter[328]. 292

III. Competition between overriding mandatory rules *legis fori* and overriding mandatory rules *legis causae*

Again, due to Art. 18 PILA, overriding mandatory rules *legis fori* would override overriding mandatory rules *legis causae*. This article orders application of the overriding mandatory rules *legis fori* without mentioning any conditions, which cannot be interpreted as anything but an order for application under any circumstances, including where the overriding mandatory rules *legis fori* in question compete with overriding mandatory rules of the *lex causae*. 293

IV. Competition between overriding mandatory rules of one third law and overriding mandatory rules of another third law

Here one can follow, to a great extent, the solution suggested by SCHNYDER, who seems to propose that a conflict between the overriding mandatory rules of different laws is remedied through conferring to each of the competing overriding mandatory rules effect which is confined within the territory of the state that has enacted such overriding mandatory rule, and where that is not possible, through giving effect to the overriding mandatory rule which is worthiest 294

[328] SCHNYDER, IPR der Leistungsstörungen, 214.

of being protected; but where also that is not possible (because none of the competing overriding mandatory rules can be qualified as worthiest of protection), through giving effect to all the competing overriding mandatory rules cumulatively[329].

[329] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 322, 323 (with regard to overriding mandatory rules that compete in international arbitration, which is to be discussed later in Part 4).

Part 4: Overriding mandatory rules in Swiss international arbitration on the example of financial overriding mandatory rules

Subpart 1: Problem

295 Overriding mandatory rules become relevant also in international arbitration, even if the latter is a dispute resolution mechanism governed by private law, as they intrude into (international) private law cases. For instance, «business crimes» which become relevant in international arbitration (money laundering; bribery; currency exchange law violations; fraud, coercion, usury, abuse of power; price fixing, cartels and other violations of competition or antitrust laws; tax evasion; securities fraud; perjury, forgery or other obstruction of justice)[330] cannot avoid being regulated by overriding mandatory rules. Indeed, overriding mandatory rules have been faced increasingly in international arbitration[331].

296 However, such rules often pose great «discomfort» for international arbitration. They tangle it up in an «identity crisis»[332]: on the one hand is its nature as a private law dispute resolution mechanism dominated by the will of the private law parties owing to which it should respect the parties' will with regard to the choice of law; and on the other hand is its character as an instrument of delivery of justice which requires preventing circumvention of law, including circumvention which might result from the parties' choice of law. It is also pointed out that in an arbitration, «countries are not parties to the dispute so

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330 KURKELA makes a list of such business crimes (KURKELA, 285).

331 See PIETH who admits: «My personal involvement as an expert on money laundering in the IPOC case and on corruption in the Fraport and the Piatco cases have [sic] opened a new world to me. I have been able to experience how as a consequence of an ever more globalised economy notions of economic crime may become decisive in civil litigation even under arbitration.». (Here, «litigation» is apparently used in its wide sense.) According to the footnotes of the cited work, the «IPOC» case refers to *IPOC International Growth Fund Ltd. v LV Finance Group Ltd., Partial Award of 19 October 2004 in an ad hoc Arbitration, Zurich*, the «Fraport» case refers to *Fraport AG v Philippines (ICSID case No. ARB/03/25)*, and the «Piatco» case refers to *Philippine International Air Terminals Co. Inc. (PIATCO) v Philippines (ICC case No. 12610)*.

332 BARRACLOUGH/WAINCYMER, VIII.

they cannot defend themselves»[333], i.e. they cannot argue the need for application or consideration of the overriding mandatory rule enacted by them. However, this should not have a great impact. An international arbitrator is enough of a «adult» to be able to appreciate on their own whether the conditions for application or consideration are met, and this is, moreover, included in their duty to resolve the case (resolving a case means subsuming the facts of the case under the appropriate law, be it overriding mandatory law or any other). In addition, it cannot be expected that a state would have a say in an international arbitration, since it is not a party to the dispute – it is true that it is interested in the enforcement of the overriding mandatory law which it has enacted, but it is interested in the enforcement of any of its laws, not only an overriding mandatory law, and it is not a party to each legal procedure that is in place.

297 In Switzerland, unlike the law on international private law proceedings before state courts (see Art. 13, 18 and 19 PILA), the law on international arbitration – Chapter 12 PILA – does not «dare» to define the treatment of overriding mandatory rules. Hence, it is not legislatively asserted whether a Swiss international arbitrator is obliged to, allowed to or even prohibited from applying or considering overriding mandatory rules; neither whether a duty would be triggered *ex officio* or upon invocation by a party, what the borders of a possibility would be, and what the sanctions for trespassing as well as the means for counteracting the vacuum caused by a ban would be. As a result, international arbitrators adjudicating out of Switzerland stand at the same crossroads at which state judges stand (the treatment of overriding mandatory rules is difficult also when regulated in the law) – but without any guidance whatsoever.

298 With regard to the borders of the problem of overriding mandatory rules in international arbitration, one should note the following. First, the issue does not occur when the *ex aequo et bono* considerations from Art. 187 (2) PILA represent the *lex causae* (accordingly, that type of *lex causae* will not feature in the present analysis). Such *lex causae* cannot contain overriding mandatory rules. It contains rules of some other system, e.g. of morals, not of law, and

[333] BARRACLOUGH/WAINCYMER, VII, B, 5, (b), (ii).

overriding mandatory rules are rules of law. Second, overriding mandatory rules of a third[334] law would not have effect where Art. 187 (2) PILA applies. Parties' authorisation under the latter excludes the effect of rules of law, except of rules of law which have an international *ordre public* character[335], *ergo*, it excludes the effect of overriding mandatory rules, including overriding mandatory rules of a third law – again, overriding mandatory rules are rules of law. It is true that the rules of law whose effect is preserved (by way of exception) – the international *ordre public* rules – constitute at the same time overriding mandatory rules, but it is not their overriding mandatory character that ensures such preservation; rather it is their international *ordre public* character.

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[334] Strictly speaking, here there is no «third» law, since there is no «first» (i.e. main) law – the *causa* is not a law (it is *ex aequo et bono* considerations).

[335] This exception is owed to the fact that Art. 190 (2) (e) PILA sets limit to all international arbitrations, including those adjudicated *ex aequo et bono*.

Subpart 2: Current solution

Chapter 17: Method

299 Since the legislation does not provide explicit rules on the status of overriding mandatory rules within international arbitration, Swiss jurisprudence and literature had to manage the situation alone, and the results are quite heterogeneous. The following approaches have been employed.

I. Conflict of laws approach

1. Characteristics

300 Under the conflict of laws approach, the conflict between the law regulating the private law relationship and the overriding mandatory law is handled through applying conflict of laws rules which resolve this conflict.

301 Within the conflict of laws approach (following the application of the respective conflict of laws rule), the overriding mandatory rule is applied as such and directly. For comparison, under the material law approach, the consequences of the overriding mandatory rule for the parties' relationship are qualified under a rule of the *lex causae* which is not a conflict of laws rule. At the end, only this rule of the *lex causae*, but not the overriding mandatory rule itself, is applied.

302 The conflict of laws approach does not have to take place within the *lex causae*. The application or consideration of the overriding mandatory rules could be a part of the application of the *lex causae*, but only with regard to the overriding mandatory rules *legis causae* and only where these are connected through the uniform connection and anyway it only could, but it does not have to, be a part. It will be a conflict of laws rule of the *lex fori* that will order the application or consideration of the overriding mandatory rules – even where overriding mandatory rules of the *lex causae* are connected through the uniform connection that will happen because a conflict of laws rule of the *lex fori* has ordered such uniform connecting, and not only because of the *lex causae*'s view on the respective rule as overriding mandatory. Thus, the conflict of laws approach is not necessarily dependent on the *lex causae*; it goes beyond the latter's borders. The material law approach, by contrast, is that – it will give

effect to overriding mandatory rules only if rules and concepts of the overning law order so (*force majeure* etc.).

The conflict of laws approach is also the method employed in PILA's Chapter 1, in particular in Art. 13, 18 and 19 PILA. It is the approach through which the characteristics of overriding mandatory rules were addressed above in Part 3: the uniform, preferential and special connections for connecting respectively the overriding mandatory rules *legis causae*, the overriding mandatory rules *legis fori* and the overriding mandatory rules of a third law are in fact instruments of the conflict of laws approach. 303

2. Legal basis

A conflict of laws rule of the *lex fori* is needed in order for the conflict of laws approach to be employed (whether by a state judge or, as here, by an international arbitrator)[336]. 304

2.1 Objective law's conflict of laws rules

a National rules' conflict of laws rules

The law on Swiss international arbitration – Chapter 12 – does not contain a basis for the conflict of laws approach, which naturally creates great uncertainty[337]. One can attempt to interpret only Art. 187 (1) PILA as containing some conflict of laws approach towards overriding mandatory rules, but that is difficult. Chapter 1 PILA has the legislative «infrastructure» in the face of Art. 13, 18 and 19 PILA, but it is questionable whether it applies to international arbitration courts apart from state courts or only to state courts. In any case, some international arbitrators who want to take the path of the conflict of laws approach apply these rules of Chapter 1 PILA, directly or indirectly, expressly or implicitly. It will be examined later on (in Chapters 19 and 21) whether that is sustainable and, if so, in what form. 305

b International public law's conflict of laws rules

[336] See also SCHNYDER, Wirtschaftskollisionsrecht, 166.

[337] VOSER, Mandatory rules, 319.

306 It is not certain whether conflict of laws rules contained in international public law acts, such as conventions, will make part of the *lex arbitri* (of the state that has signed the respective international instrument) and thus bind international arbitration courts (seated in that state). As international public law, such conflict of laws rules become part of the national law of the signatory (and take precedence over the latter's internal law). However, not all of its internal rules, but only those especially destined for this purpose, constitute the *lex arbitri* of a state. For instance, Art. VIII (2) (b) of the IMF Agreement[338] becomes part of PILA's Chapter 1 (and prevails over Art. 19 PILA, towards which it is a *lex specialis*[339] (it deals with exchange control regulations, whilst the latter with overriding mandatory rules (of a third law) from any area))[340] but it does not for certain become part of the Swiss *lex arbitri* in Chapter 12 PILA. Besides, the idea of an international public law instrument might be to have states, and not private parties like international arbitrators, as genuine addressees (the case with the IMF Agreement considered here).

307 In fact, even if they become part of the *lex arbitri,* conflict of laws rules in international public law's legal acts will play a limited role in the conflict of laws approach employed by international arbitrators towards overriding mandatory rules. First, they are a rarity. Second, they often lack binding force: international public law, especially in the financial area, is frequently soft law only (Art. VIII (2) (b) of the IMF Agreement, discussed here, is a rare hard law example). BRUMMER argues that non-binding instruments can still extract certain coercive power from non-legal sources which are «a range of reputational, institutional, and market disciplines»[341] but this is difficult to prove. Third, some instruments of international public law might not really regulate the status of overriding mandatory rules. For instance, the (anyway soft law) Hague Principles on Choice of Law make a reservation in favour of overriding

[338] As apparent from a large volume of case law, however, Art. VIII (2) (b) of the IMF Agreement brings with it its own difficulties: e.g. the definition of exchange contract or exchange regulation.

[339] VOSER, Lois d'application immédiate, 83, fn. 153.

[340] MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 31 with references. Hence, the domestic Art. 19 PILA would apply only if Art. VIII (2) (b) of the IMF Agreement does not apply, e.g. if the contract at stake does not come within the (in fact, narrow) concept of an exchange contract.

[341] BRUMMER, 284.

mandatory rules but condition this reservation on the existence of a right or obligation («… if the arbitral tribunal is required or entitled to do so» – Art. 11 (5)), thus leaving the clarification on such existence to a hard law act.

2.2 Contractual conflict of laws rules

Further, the parties' contract can provide a conflict of laws rule on overriding mandatory rules. That will be a much easier constellation for the international arbitrators because they will not need to conduct the difficult search for a specific legal basis in order to give effect to such rules. In any case, also here the ultimate legal basis for the conflict of laws approach will be the *lex fori* (in particular the *lex arbitri*) because the respective conflict of laws rule will have been adopted (in the contract) namely on the ground that such *lex fori* has empowered the parties to contract with regard to the substantive law. 308

a Standardised contracts' conflict of laws rules

Standardised contracts in the financial and international arbitration sphere have diverse approaches towards overriding mandatory rules. Some of them are not very helpful. The ISDA/IIFM Tahawwut Master Agreement avoids the question of the relation between its rules and overriding mandatory rules – in its footnote 9, it makes a reservation that the proposal in it for the governing of an international arbitration by the ICC Rules does not guarantee the compliance of the latter with Sharia rules, which probably includes Sharia's overriding mandatory rules. The UNCITRAL Arbitration Rules recognise the power of mandatory rules, although only of procedural mandatory rules[342]. On 309

[342] Their Art. 1 (3) reads: «These Rules shall govern the arbitration except that where any of these Rules is in conflict with a provision of the law applicable to the arbitration from which the parties cannot derogate, that provision shall prevail». Under «the law applicable to the arbitration», procedural and conflict law is understood because it must be a law that regulates the same issues as the issues which the UNCITRAL Arbitration Rules regulate and the latter, as any other arbitration rules, give only a procedural and conflict law basis to the international arbitration; besides, interpretation of that wording which encompasses also substantive applicable law would be *reductio ad absurdum*: the UNICITRAL Arbitration Rules refer to the application of a certain substantive law (through Art. 35, in particular Art.

the other hand, the Loan Market Association Facility Agreement for pre-export finance transactions[343] delivers an opportunity for the stipulated (in Sec. 12) arbitral tribunal to apply or consider financial overriding mandatory rules. Its clause 27.19 «Convertibility/Transferability» which, amongst other things, deals with restrictions, prohibitions or delaying of payments, covers, for example, borrowers not in a position to repay their pre-export loans because they were not paid by Greek buyers of the goods they exported into Greece after (in the summer of 2015) a local law suspended the export of capital; clause 27.20 addresses such a moratorium on payments.

b Individual contracts' conflict of laws rules

310 There are some examples of individual agreements for which international arbitration is a possible jurisdiction and which provide for the precedence of overriding mandatory rules over their stipulations. The agreement between Mitsubishi and Morgan Stanley, for example, provides that overriding mandatory rules have precedence over the agreed confidentiality. Then, Art. XI, clause 11.15 of the Shareholders' Agreement that Banco Bilbao Vizcaya Argentaria has with several Turkish companies[344] prescribes (a) that Turkish law (the law of incorporation of the company whose shareholders are concluding the agreement) prevails over a provision of the contract, and (b) that fiduciary and good faith duties of a company's directors take precedence over the contract[345].

3. Cases

311 ### *3.1 ICC Case No. 8528*

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35 (1)) and the rule which under that law is applicable to the case «is in conflict» with another provision of the same law (Art. 1 (3)).

343 This is a model agreement for pre-exporting financing contracts. Such contracts are loans (ordinary or syndicated) granted by a bank/banks to an exporter for financing the production and supply (when the exporter is the producer) or the purchase (when the exporter buys from the producer) of goods to be exported. The Loan Market Association Facility Agreement for pre-export finance transactions is intended to master syndicated loans.

344 BBVA 20-F-Form for 2011, Exhibit 10.3.

345 Article XI, clause 11.10 of the Agreement stipulates jurisdiction of an arbitral tribunal.

ICC Case No. 8528 (which will be discussed below in relation to the arguments for and against application of PILA's Chapter 1 to overriding mandatory rules in international arbitration) involves a conflict of laws approach, since within it a conflict of laws rule – Art. 19 PILA – is applied. The case will be discussed in more detail below; here it is mentioned only as an example of the use of the conflict of laws approach.

3.2 Megafon case

312 The so-called «*Megafon case*», which has given rise to several procedures, involved two contracts dated 10 April 2001 and 12 December 2001 granting call options on company shares. English governing law and Swiss seated arbitrations had been stipulated. An international arbitration procedure based in Geneva was initiated by the buyer after it exercised the options, but the seller refused to perform and sold the shares which were subject to the options to other persons. The seller contended that the exercise of the options and the options themselves were invalid. The buyer won this international arbitration with an arbitrators' decision from 16 August 2004. The seller could not obtain annulment of this award (*DSC 4P.208/2004 of 14 December 2004*) but succeeded with a request for its revision based on newly revealed evidence demonstrating that it had been influenced or procured by a crime (*DSC 4P.102/2006 of 29 August 2006*).

313 Within a parallel international arbitration seated in Zurich, actions for performance of the call options or alternatively for damages for non-performance were dismissed, with some of the requests declared moot and with two partial arbitral awards from 19 October 2004 and 16 May 2006. The object and purpose of the call option agreement of 10 April 2001 had been illegal, *ergo*, the agreement was unenforceable. The action had been made *ex turpi causa* and because of that was in breach of public policy. The award from 16 May 2006 was unsuccessfully challenged before the Court (see judgment of 19 February 2007 in *4P.168/2006*) with allegations that the arbitral tribunal had exceeded its powers in establishing a violation of Russian criminal law and that there had been an infringement of the right to be heard. With regard to the (here relevant) assertion about the arbitral tribunal exceeding its powers, the *curia* pointed out that the legal ground for such a challenge must be Art. 190 (2) (b) PILA – an arbitral tribunal wrongly assuming powers. In such a situation, the

Court first examined whether the claim was arbitrable according to Art. 177 (1) PILA. Its finding was positive. The dispute evolved over pecuniary interests. That was not changed by the fact that the presence of potential (which i.c. turned out actual) committal of a criminal offence was examined, because such examination had only preliminary purposes for the main question, which remained one of a pecuniary nature – that of performance of call options over company shares. Since only valid agreements could give rise to proprietary rights, before enforcing the rights that an agreement is said to confer, one had to appreciate whether such an agreement had produced legal effect. This appreciation included control for the existence of grounds for invalidity of the contract, such as the committal of a crime in relation to the contract. That arbitrator's evaluation of grounds for invalidity was not hindered by the fact that one of those grounds (the committal of a crime) had other legal consequences (criminal law consequences) to be enforced by another adjudicator (a state court), since the arbitrator did not take away the exclusive prerogative of this other adjudicator in imposing such other consequences – through this evaluation he or she did not impose these other consequences but only considered the influence of the ground for them (the committal of the crime) on the validity of the contract.

314 The international arbitrators and the Court here applied a (third law's) overriding mandatory rule – a money-laundering prohibition – to a financial transaction (call option). The conflict of laws approach was used. The fact that its violation was seen as rendering the contract invalid means that the foreign overriding mandatory rule in question was treated as a law and a foreign overriding mandatory rule was treated as a rule within the conflict of laws approach – the material law approach perceives a foreign overriding mandatory rule as a fact (if it was employed here, the contract would have been characterised as impossible or immoral rather than illegal).

3.3 The English cases Ralli Brothers and Foster

315 *Ralli Bros. v Compania Naviera Sota Y Azinar (1920).26* («*Ralli Brothers*») is a famous English decision creating a rule that has become known as the «Ralli rule» (or the «Ralli principle»), according to which contracts whose performance is illegal under the law at the place of performance are unenforceable in England except where the foreign law that would be breached is revenue or

fiscal law[346]. I.c. an English-governed contract stipulated a certain amount of freight due from charterers to Spanish shipowners upon the delivery of a cargo in Spain, but after the conclusion of the contract its performance became illegal under Spanish law, since the latter set a limit on freights to be charged by shipowners which was exceeded through the freight agreed on. The English court refused to order recovery of this stipulated freight. The case is interesting for the topic of the conflict of laws approach in particular because there is a heated dispute as to whether it created a conflict of laws or a substantive rule – which is the same as a dispute as to whether the conflict of laws or the material law approach was taken. Here, the first possibility is viewed as more plausible[347]. The judgment refers to illegality, and not impossibility or immorality, of the performance, which means that the foreign law is understood as a law (which is how the conflict of laws approach perceives foreign law) and not as a fact (which would have been the view of the material law method). Then, the fact that the established rule envisages exceptions for revenue and fiscal rules of the foreign law speaks for a conflict of laws nature, since such exceptions would not have been necessary within a material law approach – for the latter it would not have mattered whether it was a foreign rule which expressed the foreign state's sovereignty intensively, like a revenue or fiscal rule, or another rule that hindered the contract's performance. It is true that the English court did not grant entire nullity of the contract, but only unenforceability, which is less intense protection of the concerned overriding mandatory rule (because, unlike nullity, it does not, for example, entail the returning in accordance with unjust enrichment rules of what was surrendered under the contract); but a weaker degree of effect, as here, is something the conflict of laws approach knows of – for example, Art. 19 PILA gives effect to a foreign overriding mandatory rule in the form of consideration of such rule.

The English case *Foster v Driscoll [1929] 1 KB 470* («*Foster*») also deals with illegality under foreign law. The literature debates whether the principle established in the case supplements or coincides with the Ralli principle, and the 316

[346] Actually, there is a discussion whether the Ralli rule is superseded by Art. 9 (3) Rome I (another sign that the rule deals with overriding mandatory rules), a debate which might become superfluous if after its exit from the EU, Rome I ceases to apply to Great Britain.

[347] – and that is why the case is discussed here when dealing with the conflict of laws method.

majority appears to see separateness. In *Foster*, a group of persons, aiming at making profits, had planned to ship whisky to North America, where at the time a prohibition on alcohol was in force. A dispute arose between them and they brought it to the court, which refused to give assistance for the performance of the contract, establishing the principle that: «An English contract should and will be held invalid on account of illegality if the real object and intention of the parties necessitates them joining in an endeavour to perform in a foreign and friendly country some act which is illegal by the law of such country notwithstanding the fact that there may be, in a certain event, alternative modes or places of performing which permit the contract to be performed legally.». *Foster*, like *Ralli Brothers*, is ambiguous on the approach it uses – the conflict of laws or the material law approach. Like in *Ralli Brothers*, more indications of the former method are seen. Firstly, the court recognises the foreign law as law – it talks about invalidity of the contract – «on account of illegality» (an argument found in *Ralli Brothers* as well). Second, that the court's reasoning is «notwithstanding the fact that there may be, in a certain event, alternative modes or places of performing which permit the contract to be performed legally» shows that whether the contract is unacceptable in view of the foreign law is relevant independently of whether the contract is valid under the *lex causae*; in other words, that the «opinion» of the *lex causae* is not enough, as it would have been under the material law approach.

3.4 Castillo Bozo

317 *The US case Juan José Castillo Bozo v Leopoldo Castillo Bozo and Gabriel Castillo Bozo, 12-cv-24174-Williams*, in the United States District Court for the Southern District of Florida, 2013 (referred to as «*Castillo Bozo brothers*») is here attributed a discussion which is less traditional, for it deals with arguments that could have been, but were not, raised. The case involved a stock purchase agreement concluded in 2008 by the Venezuelan citizen Juan José Castillo Bozo with his brothers (also Venezuelan citizens) *Leopoldo Castillo Bozo and Gabriel Castillo Bozo, according to which the former was to transfer to the latter his shares in* various Venezuelan companies (part of a financial group) *against consideration.* The stock purchase agreement provided for the application of Florida law and for the resolution of disputes through arbitration

in Miami (Florida) before the American Arbitration Association under the latter's International Arbitration Rules. The price for the transfer was not paid, and *Juan José Castillo Bozo* claimed it in *a Miami arbitration, obtaining, on 13 November 2012, a favourable award.* On 21 November 2012, *he* requested the United States District Court for the Southern District of Florida to enforce this award in accordance with the Inter-American Convention[348] and with US law, prompting the (positive) judgment from 2013 discussed here. Venezuelan financial markets law required that transactions causing change of control over companies such as the transfer of shares stipulated in the stock purchase agreement in question be authorised in advance by two Venezuelan authorities (Superintendencia de la Actividad Aseguradora – «SUDESEG» – which supervises insurance activities, and Superintendencia de las Instituciones del Sector Bancario de Venezuela – «SUDEBAN» – which monitors banking institutions). Such authorisations were not obtained. This incompliance with Venezuelan financial regulations is why the case is considered here.

The Venezuelan requirements for authorisations could have been regarded as overriding mandatory rules; even as overriding mandatory rules of *ordre public* character. 318

As overriding mandatory rules, they could be seen because they dealt with issues of public interests – they regulated a business (in particular the change of control over companies participating in a business), which impacted the wellbeing of the public at large – the financial services' business. 319

This overriding mandatory rules character of the Venezuelan authorisation requirements could have been invoked by the defendants in the arbitration, in particular with the contention that these requirements had to be applied in their capacity as overriding mandatory rules of a third law which was closely connected to the case. One could have contended that there was such close relation of the third law to the case because this law was the law of the country in which the companies, whose shares were being transferred through the arbitrated stock purchase agreement, were incorporated. In other words, the respondents 320

[348] The Convention does not, for example, mention that it applies only to foreign awards, which makes one conclude that it applies also to domestic awards – as in the current case, where enforcement of a US award is sought in the US.

could have demanded that the international arbitrators conduct (the difficult) balancing between the stock purchase agreement (in particular the obligation under it to pay the price), the *lex causae* and the overriding mandatory Venezuelan authorisation rules – balancing analogous to that which the Swiss seated international arbitrators delivering the award in ICC Case No. 8528 characterised as the arbitrators' task[349]. It is not known whether the defendants made such a point, and in fact it is more probable that they did not if one considers that their argumentation before the enforcing court did not address the Venezuelan requirements as a third law[350].

321 As far as the enforcement proceedings before the US state court are concerned, within them the overriding mandatory character of the Venezuelan financial regulations would anyway not have brought a successful argument for the defence because the violation of overriding mandatory rules was not a ground for refusing enforcement (only the infringement of *ordre public* was – Art. 5 (2) (b) of the Inter-American Convention).

322 One could have gone even further and argued that the Venezuelan authorisation requirements were not *simpliciter* overriding mandatory rules but overriding mandatory rules of *ordre public* character; in particular that those rules not only dealt with issues of public interest (because they regulated a business which influenced the wellbeing of the general public – the financial services' business), as elaborated above, but that they also made part of the rules and concepts without which a legal order did not exist.

323 The defendants could have provided such argumentation within the arbitration procedure. Again, there is no information whether they did so.

324 In any case, the invocation of the *ordre public* status of the requirements in question was more vital in the enforcement proceedings before the US state court than in the arbitration procedure; there, that was the only characteristic of these rules which (of course, together with the fact of the violation of such

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[349] See para 32 of the award: «…It is the arbitrators [sic] duty to see how to harmonize the agreement, the lex causae and the Turkish law.»

[350] – but as *lex causae*, obviously wrong treatment since a choice of law clause in the stock purchase agreement provided for the application of Florida law.

rules) could have paralysed the enforcement of the award – an overriding mandatory nature would not have sufficed. The defence could have argued that the award's enforcement had to be refused, since the Venezuelan authorisation requirements made part of the *ordre public* within the meaning of Art. 5 (2) (b) of the Inter-American Convention and the incompliance with them infringed such *ordre public*. The *ordre public* whose invocation could have brought some argument for the defence was not that of Venezuela – Art. 5 (2) (b) of the Inter-American Convention which provides that the violation of the *ordre public* can be a ground for refusal of enforcement refers to public policy of «that State» where «that» refers to the state in which recognition and enforcement is sought; which is here the US, not Venezuela. Hence, a violation of the Venezuelan *ordre public* could be taken into consideration only out of a sense of loyalty. Contending a breach of the international *ordre public* would also not have represented the most beneficial strategy. Even if one accepted that (despite its phrase «*that* State» (emphasis added)) Art. 5 (2) (b) of the Inter-American Convention envisaged the international (not the enforcing state's) *ordre public* (because this was how the practice and literature read the *ordre public* contained in another convention whose interpretation served as a model for the interpretation of the Inter-American Convention – the *ordre public* in Art. V (2) (b) of the New York Convention[351]), it would have been difficult to demonstrate that the Venezuelan authorisation requirements made part of the international *order public*, since financial regulations rarely reach the high rank of *ordre public*. The safest way to go was to interpret Art. 5 (2) (b) Inter-American Convention's wording («that State») as referring to the state seized with the request for recognition and execution of the award – the US. With such a starting point, one could argue that the award violated US public policy, since it ordered the performance of an obligation (that to pay the

[351] Such interpretation by analogy of the provision of another convention is quite brave but is justified since the court itself stated that one needed to read the two conventions in question in the same way (II. «Analysis», p. 3 and 4 of the judgment and the authorities cited there), and, moreover, the court alone applied interpretation of a concept contained in the New York Convention to a concept provided for in the Inter-American Convention (it read «law» in the expression «according to the law of which the decision has been made» in Art. 5 (1) (e) of the Inter-American Convention in the same way as the term «law» in Art. V of the New York Convention was read – as «procedural law» (II. «Analysis», point 3., p. 9 and 10 of the judgment)).

price) whose synallagmatic obligation (that to transfer the shares) was not complied with (in particular because the legal requirements for such complying were not fulfilled; these were the legal requirements of the place where the shares' transfer was to take place, which was Venezuela, for the transfer could not take place other than in the country in which the companies whose shares were being transferred were incorporated). That would have been a logic similar to that of the *Reteitalia* international arbitral tribunal, with the difference that here the impossibility would have been subsequent, not initial – it would have occurred after the conclusion of the contract (at the time of the conclusion, it was still possible that the authorisations could be obtained) – and that the impossible contractual obligation would have been the one synallagmatic to the contractual obligation whose performance was sought rather than the contractual obligation whose performance was sought[352]. However, the defendants invoked the Venezuelan requirements through the wrong angle. On the one hand, they invoked the incompliance with these requirements as if it was incompliance with the *lex causae*[353] stating in this way that Venezuelan law was the *lex causae*, which was obviously untrue. On the other hand, instead of deriving an infringement of the *ordre public* from the infringement of the Venezuelan requirements, they argued that *ordre public* (in particular US *ordre public*) would have been violated if a Venezuelan state court judgment which condemned this infringement[354] was ignored – a contention which was, moreover, destined to fail because the concerned Venezuelan court was incompetent and which was, in addition, unnecessary since the nature of rules as *ordre public* rules, and thus the characterisation of the violation of such

[352] Though the logic with regard to contractual impossibility would be similar to that used in *Reteitalia*, the approach would be different. Not the material law (like in the latter case) but the conflict of laws method would be employed. The public policy, violation of which would be proved, would be invoked not in its capacity as the public policy of the *lex causae* (like in *Reteitalia*) but in its capacity as the public policy of the forum – the invoked Art. 5 (2) (b) of the Inter-American Convention talks about the public policy of the state asked to enforce the award i.e. of the forum. The fact that in this concrete case the public policy of the forum was also public policy of the *lex causae* because the parties had nominated the law of the court as applicable law would not have changed anything.

[353] See II. «Analysis» of the judgment.

[354] The defendants had filed a successful request for the annulment or vacation of the arbitral award with a state court in Venezuela.

rules as a violation of *ordre public*, does not depend on confirmation by any court. One should note that also the US judges might have had to raise the relevance of the Venezuelan authorisation requirements since, upon interpretation *a contrario* from the first paragraph, the second paragraph of Art. 5 of the Inter-American Convention, including specifically Art. 5 (2) (b), seems to be applicable *sua sponte* (it does not, like the first paragraph, contain the phrase «at the request of the party»).

4. Evaluation

4.1 Pro

The conflict of laws method is the most natural approach towards overriding mandatory rules which become relevant in a dispute submitted to international arbitration; it is the approach which one thinks of first, which one chooses subconsciously. This is so because private international law which regulates international arbitration utilises predominantly conflict law. Besides, it is most logical that one first tries to resolve the status of overriding mandatory rules through the means used for the other rules relevant in international arbitration (the ordinary rules), which is namely the conflict of laws approach, including by adapting these means; one goes for another strategy solely if this turns out unhelpful (i.e. at any case one should first try with the conflict of laws method). Undertaking the conflict of laws approach is logical also because of the presence of a conflict of laws element in the composition of overriding mandatory rules. Last but not least, foreign overriding mandatory rules can exist merely within the conflict of laws approach as only this approach recognises them as rules which they by default are («overriding mandatory *rules*»). 325

4.2 Contra

Even if theoretically correct, in Switzerland the conflict of laws method is fragile. For international arbitration courts it does not have any legal basis, and its legal basis for state court procedures features certain unclarities (e.g. in Art. 13 PILA, second sentence). 326

II. Material law approach

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The material law approach is the second choice. It is employed where there is no possibility of using the conflict of laws method.

1. Characteristics [355]

328 Through the material law method, the application or consideration of what under the conflict of laws approach represents overriding mandatory rules is realised as part of the application of the *lex causae*, i.e. as if it constitutes application of the *lex causae*. The «overriding mandatory rules» are deemed as facts which are subsumed under certain rules and concepts of the *lex causae*. Examples of such rules and concepts are legal impossibility (e.g. resulting from *force majeure*), *clausula rebus sic stantibus*, violation of the *bonos mores*, lapse of legal basis[356]. Directly applied is this rule or concept of the *lex causae*; the overriding mandatory rule is applied or considered only indirectly and only under the ultimate control of the *lex causae*. Since a rule or concept of the *lex causae* is applicable, it is the latter's ideas of what leads to legal impossibility, what contravenes the *bonos mores,* etc. that are relevant. Thus, in a strict sense, the material law approach utilises the content of the rule which under the conflict of laws approach would be an overriding mandatory rule – not the rule itself.

329 Within the material law method, the foreign overriding mandatory rule is a rule solely for the foreign law. For the *lex causae*, it is merely a fact, and it is subsumed under a rule of the *lex causae* in the same way as any other fact.

330 Not only is the «overriding mandatory rule» not considered a rule, but further, the characteristic of «overriding» becomes pointless under the material law approach. The foreign rule in question does not override any domestic rule: domestic rules are what gives effect to the content of the foreign rule, hence, it would be absurd if these domestic rules are overridden by the latter. The domestic rules refer to the solution of the foreign rule, so there cannot be contradiction between them and the latter – even less can the latter be overriding.

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[355] See SCHNYDER, Vertragsstatut, 683, 691.

[356] – some enumerated in SCHNYDER, IPR der Leistungsstörungen, 212. See also MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 25b.

In addition, no «going outside» of the borders of the *lex causae* takes place, hence, there is no encounter of such *lex causae* with the foreign law.

The material law approach is, in fact, nothing else than an artificial «pouring» of the foreign law into the *lex causae*. That is apparent, for example, from the case *Privredna Banka Zagreb* and in particular from the (here contended) presence of a conflict of laws «nuance» (next to the dominating material law approach) in it (see below at 5.2, a.). 331

Since within the material law method it will always be the application of the *lex causae* that will trigger the *de facto* effect of the content of «overriding mandatory rules», i.e. since all that will be applied or considered[357] will be the *lex causae*, it will not matter whether the «overriding mandatory rules» belong to the *lex causae* or not. Accordingly, division into rules *legis causae* and rules of a third law will be pointless. 332

2. Material law approach towards the reflexive effect of «overriding mandatory rules»

The material law approach can be used for the reflexive (side, indirect, derived) effect of the rules that under the conflict of laws approach would have constituted overriding mandatory rules. Here the material law approach reveals more usefulness than with regard to the direct effect of «overriding mandatory rules». 333

The reflexive effect of overriding mandatory rules is the impact which the original (underlying) effect of overriding mandatory rules – their effect on a relationship coming within their scope – would have on another relationship which does not come within their scope. For instance, through restricting the export of capital, an overriding mandatory rule hinders A in making a payment to B (who is situated abroad) under an existing contract between A and B, and that influences a contract between B and C which (contract) is otherwise not covered by the overriding mandatory rule in question because B was relying on the financial means that it was to receive from A under its contract with A 334

[357] – actually only applied, since it is all *lex causae* and this is always applied; there are no third overriding mandatory rules, which usually are the subject of consideration.

in order to pay C under its contract with C so that it invokes the failure by A to pay it as an excuse for its failure to pay C.

335 This reflexive effect might at first sight seem to be precluded by the principle of relativity of contracts according to which a contract binds only the signing parties, which means that it is independent from any other contract. However, this principle does not prevent non-legal (e.g. economic) connections between contacts to be reflected in the legal regime of the latter. Moreover, such connections might be strong, especially in the financial sphere, where contracts would often be concluded with the sole purpose of ensuring the financial means necessary for the performance of another (frequently non-financial) contract (e.g. a loan that a business enters into in order to be able to pay the company which is to construct a factory for it).

3. Legal basis

336 Below are some examples of concepts of Swiss law which are capable of being used for the material law method. They will be available where the *lex causae* is Swiss law.

3.1 Impossibility of the contract's terms

337 The impossibility of the contract is actually the impossibility of the performance of the contract. In Germany, for example, the impossibility of the performance (§ 275 (1) GCC[358]) is referred to.

338 The impossibility of the contract's performance can be *ab initio* or subsequent. The *ab initio* impossibility is present already upon the conclusion of the contract. In Switzerland, its consequences are regulated in Art. 20 (1) CO, first hypothesis. The subsequent impossibility, or under the English legal doctrine the frustration of the contract, is present when the subject matter of the contract becomes impossible after its conclusion, i.e. in the time between the contract's conclusion and the planned start of its performance. The subsequent impossibility to perform, which is not caused by the debtor, i.e. the objective subsequent impossibility to perform, is regulated by the Swiss legislation through

358 Art. 275 (1) GCC reads: «The claim on performance is precluded in so far as such performance is impossible for the debtor or for any other person».

Art. 119 CO. The debtor is released from such impossible performance. Thus, for example, a non-Swiss law's ban on the export of capital abroad can be reckoned as causing the impossibility of the performance of a contract governed by Swiss law. If the ban was in force already at the time of the conclusion of the contract, the latter will be null under Art. 20 (1) CO, first hypothesis, and, if it has been enacted only after such conclusion, Art. 119 CO can be applied to release the debtor from the (now impossible) performance of its obligation.

The cause of objective subsequent impossibility, known as *force majeure* (or *superios force*), is an extraordinary circumstance which is beyond the control of the party that had to perform. Because it is outside the control of the party, the *force majeure* exempts the latter from the obligation to perform. In the real economy, *force majeure* is invoked often; it is capable of being relied on in finance as well. *Force majeure* can be a natural event or occurrence (or an act of God, as it is known in the English-speaking legal literature), an act of humans, such as a war or strike, and an act of a parliament, such as a law (the so-called act of state). The act of state is considered by some as an autonomous doctrine separate form *force majeure*. It is questionable whether, next to those of states, the acts of other bodies possessing public law powers, like international organisations, can constitute *force majeure*. Where these acts, as is frequently the case, are soft law, the answer would be rather negative. This uncertainty is evidenced by the decision of the arbitrators that adjudicated out of Switzerland in the international arbitration regarding which the Court rendered judgment *4A_16/2012 of 2 May 2012* (rejecting an application for annulment on procedural grounds not relevant here). I.c. a UN expert commission's recommendation was not recognised as a *force majeure* which could exculpate a Luxembourg trading company from its liability for premature termination of a Swiss-governed contract with a Congolese supplier of cassiterite. In relation to a resolution of the UN Security Council establishing that illegal exploitation and trade of natural resources were connected to distribution and trafficking of weapons which brought about deterioration of the conflicts in the Great Lakes region of Africa, the UN expert commission had recommended to the Luxembourgish company to terminate the agreement because of lack of proof of the origin of the traded material. 339

340 Illegality under foreign law is impossibility under one's domestic law. It cannot be illegality under one's domestic law, since the latter does not consider foreign law as law – only as fact – and it cannot, thus, see a violation against such foreign law as an unlawful act (illegality under the second hypothesis of Art. 20 (1) CO is contradiction with domestic law[359]). The conflict of laws approach is less problematic in this respect, as under it, foreign law is law (whose applicability the domestic (conflict) law orders).

3.2 Immorality of the contract

341 The substance of the foreign law (which is again a fact, not law) can be considered part of the *bonos mores* and be protected where domestic law confers protection to the latter. For instance, under Swiss law, a contract that violates the *bonos mores* is invalid (Art. 20 CO).

4. Cases

4.1 Reteitalia

342 *Reteitalia* was an unsuccessful challenge of an international arbitral award which declared a selling option void because the sale subject matter of the option was impossible since it would have violated mandatory requirements of a third law under which the company whose shares had to be sold was incorporated. The mandatory requirements set a maximum threshold of participation in a company within the media industry. In 1990, Hachette S.A. (afterwards Matra-Hachette S.A. and here «Hachette»), a French company, stepped in the capital and became the operator of La Cinq, a French TV channel. The same year Hachette entered into a contract with the Italian company Reteitalia SpA («Reteitalia») in which it promised, under certain terms and conditions, to purchase itself or cause a third person to purchase the shares of Reteitalia in La Cinq. The agreement provided for Swiss law to govern it and for Geneva arbitration to resolve potential disputes. In 1992, the French media supervisory authority Conseil Supérieur de l'Audiovisuel («CSA») withdrew the broadcast licence of La Cinq. Already in 1991, Reteitalia had availed itself of its right to sell the shares to Hachette and invited the latter to pay it the sum agreed on in

[359] SCHNYDER, Wirtschaftskollisionsrecht, 308.

the contract. Hachette refused to do so, putting into question the validity of the contract and arguing that the conditions for the exercise of the promise had not been met. In 1992, Reteitalia initiated arbitration which ended with an award from 1999 rejecting the claim, *inter alia*, on the basis that the contract was null under Art. 20 CO due to initial impossibility. The purchase of shares by Hachette would have increased its participation in the capital of La Cinq to a percentage above 25 %, which was the limit set by French public media law. A simple payment by Hachette of the agreed price without the simultaneous transfer of the shares would have rendered Reteitalia a straw man, which was equally prohibited by that law. The alternative of Hachette causing a third person to purchase the shares was also excluded *ab initio*, for the fixed price in the contract hindered the finding of such a third person, and an acquisition by a third person would have indispensably led to the withdrawal of La Cinq's broadcast licence by CSA, who had proclaimed the remaining of Reteitalia as one of the shareholders an absolute condition for preserving this licence. Such selling option being null, the arbitrators deemed its «exercise» by Reteitalia was also void. In addition, the tribunal denied Hachette's precontractual liability, since the contractors were completely aware of the French law's prohibitions. Reteitalia challenged the decision of the arbitrators, alleging that the latter's refusal to apply the contract violated the public policy under Art. 190 (2) (e) PILA, more precisely the principle *pacta sunt servanda*. The Court rejected this contention of Reteitalia, basically saying that it was in line with that principle to refuse to enforce a contract which one deemed void, as done here. The principle would have been contravened if the arbitral tribunal had refused to enforce a contract which they thought was valid.

4.2 BIS case

Also worthy of note is an interesting non-Swiss arbitral award: the decision of 343
the Permanent Court of Arbitration in The Hague in *Dr. Reineccius et al. v BIS*. The dispute in question evolved between the Bank for International Settlements («BIS» or «Bank») and some of its private shareholders. BIS was created through an international treaty as a company limited by shares held by sovereign states with an option for the latter to issue or cause to be issued to the public their shares (Art. 16 of the Statutes of the Bank). Some of the states took advantage of that option so that there were also private, apart from public,

law persons amongst the Bank's shareholders. In September 2000, the BIS Board of Directors decided to exclude such private shareholders (at that time possessing 13.73% of the shares) against compensation. Three of those shareholders put into question the size of the compensation, in particular the method for appreciating the basis for the determination of such size – the value of the shares. One of them also challenged the lawfulness of the shares' recall. The latter challenge was rejected by the arbitral tribunal. As for the former, the arbitrators agreed with the petitioners that the method used was incorrect, but they disagreed that the right one was that which rested on the logic that a company acts for the welfare of its shareholders and therefore maximises the dividends for them. In the tribunal's view, BIS was of a *sui generic* nature, being at the same time an international organisation with «a public international mandate» and a company limited by shares; a nature distinct from that of «most domestic and private sector corporations in advanced capitalist systems» for which the mentioned logic of maximisation of profits to the benefit of the shareholders was indeed valid. The tribunal underlined that according to the Board, the public international mandate of the Bank was to be best served if a significant part of its profits were accumulated into its statutory reserves instead of being paid out as dividends. Moreover, BIS' privately held shares had had additional encumbrances[360] (resulting from the public law component in its legal nature).

344 Even if it does not have the classical elements of the hypothesis analysed here, since it involves corporate (next to financial markets private) law and international (rather than national) public law, this case is an example of the giving of precedence to law serving public interests over a private law principle (the principle on the determination of value of private law companies' shares). The method through which such precedence was given was the material law approach: the very contract – the treaty through which BIS was created – contained the law serving the respective public interests. Unlike in other cases, the use of this approach here cannot be criticised. The reason is that it was the only

[360] The shares could be sold solely with the consent of BIS and of the central bank to whose national issue they belonged (an encumbrance which was also reflected in the discount of 75 % given by the markets to their net asset value); they did not confer governance rights on their holders; and they entitled their holders only to profits as determined by the General Meeting and by the Board of Directors rather than any profits.

possible method. The contract – the treaty through which BIS was created – was not subordinated to any objective law (as a contract between typical private parties would have been), for in international public law, parties are not subject to the power of any higher jurisdiction (they are equal) and all rules that can bind them, except for the principles of international public law which were irrelevant i.c., are contained in the contracts concluded between such parties (in «treaties»).

4.3 Last sentence of cons. 5, c), bb) of DSC 118 II 193

The reasoning of the Court in the last sentence of cons. 5, c), bb) of *DSC 118 II 193* that an arbitrator had to examine a law which could have rendered invalid a contract whose performance they were asked to adjudge, as otherwise they would not be capable of such adjudging since they would not know whether they had to carry it out with regard to performance of a valid or an invalid contract, is also application of the material law method. 345

5. Evaluation

5.1 Pro

The persons who criticise the material law approach at the same time recognise its significance[361]. For instance, SCHNYDER rightly underlines that the material law approach has led to some reasonable individual results (e.g. to the consideration of foreign prohibitions regarding the protection of cultural goods)[362] and that: «from the point of view of the respective decision's result and the state and private interests involved in a case it is in the first instance not significant whether foreign overriding mandatory law is considered on the ground of a conflict of laws reference or at a material law level – within the application of the substantive law which according to PILA is governing law. Important in all these cases seems to be the recognising of a foreign legitimate (regulatory) interest which is reflected in the imperative willingness for applicability 346

[361] SCHNYDER, Wirtschaftskollisionsrecht, 315, *in initio*.

[362] SCHNYDER, Wirtschaftskollisionsrecht, 315.

of the foreign overriding mandatory rule.»[363]. Thus, one cannot deny that the material law approach is a convenient method. Its practicality is all the more valuable where its opposite – the conflict of laws approach – creates many troubles because it lacks the necessary legislative «infrastructure», as is the case in Switzerland. Moreover, in SCHNYDER's view, Art. 19 PILA does not hinder the subsuming of foreign overriding mandatory rules under material law concepts where special conflict of laws connecting of such overriding mandatory rules was rejected[364]. Also, in Germany, as reported by LEHMANN, the majority of authors favour the employing of the material law approach for addressing foreign rules which deal with public interest, such as foreign financial markets rules[365].

347 In addition, in some specific cases, such as *Dr. Reineccius et al. v BIS*, touched upon above, (for the reasons provided there) the material law approach is the only possibility.

5.2 Contra

348 The material law approach has certain drawbacks. Its application to foreign overriding mandatory law is criticised, for example by KARRER[366] and SCHNYDER[367]. The latter summarises the main points on which the critics rest[368]. First, the material law approach is contrary to the territoriality principle. Second, with it conflict of laws results are achieved «without that being named and reflected on» from which a deficit of regulatory (conflict) law dogmatisation of interests in application arises, and in extreme cases such deficit can lead to

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363 SCHNYDER, Wirtschaftskollisionsrecht, 190 (first paragraph thereof), own translation from German. By foreign law or interest, the author seems to mean a law or an interest that not only does not belong to the legal system whose law is the *lex causae* but also does not belong to the legal system which offers the forum; however, the logic can be applied here as well.

364 SCHNYDER, Wirtschaftskollisionsrecht, 352, 353.

365 LEHMANN, 520, fn. 571.

366 KARRER, BSK IPRG, Art. 187 N 289.

367 SCHNYDER, Wirtschaftskollisisonsrecht, 315.

368 SCHNYDER, Wirtschaftskollisisonsrecht, 315.

disoriented and arbitrary case law. Third, granting privilege to overriding mandatory law which belongs to the *lex causae* towards overriding mandatory law derived from a third law only on the basis of such belonging is not feasible. Fourth, it could be that the material law approach is not possible because the material law in question contains no «gateways» for the consideration of the foreign law (i.e. no concepts of immorality, impossibility or similar). Also, LEHMANN objects to the use of the material law method for supervisory financial markets law even if, as mentioned, in Germany this method is supported; in his opinion, while the material law method is effective for supervisory financial markets rules of the *lex causae*, it does not guarantee the consideration of supervisory financial markets provisions belonging to other laws[369]. To those arguments of the literature, one can add that the concept of «foreign overriding mandatory rule» cannot exist within the material law approach since the latter does not recognise a foreign rule, including a foreign overriding mandatory *rule*, as a rule (but only as a fact) – hence, strictly speaking, what is done under the material law approach is not application or consideration of an overriding mandatory *rule*.

a *Privredna Banka Zagreb*

The material law approach is even more inapt where it is artificially imposed on a case that is otherwise suitable for being treated through the conflict of laws approach. *Privredna Banka Zagreb* demonstrates this. The case was decided by a state court but the choice between the material law approach and the conflict of laws approach is not so different for international arbitration courts, which is why it makes sense to analyse it here. *Privredna Banka Zagreb* was on an (unsuccessful) appeal before the Court from the commercial court of Zurich, which had refused to enforce a Swiss-governed promissory note issued by the Croatian bank Privredna Banka Zagreb («PBZ») (instructed by the Republic of Croatia) to Intersystems, Inc. («Intersystems»), a company based in Beirut, in connection to (though as a promise independent from) a 1992 purchase of weapons by the Republic of Croatia (at that time in a war conflict with Serbia) from Intersystems. The latter had ceded its right under the promissory note to Beverly Overseas SA (established in the British Virgin

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[369] LEHMANN, 521.

Islands) which, following PBZ's refusal to pay, filed a lawsuit with the competent (in accordance with a concluded jurisdiction clause) Swiss courts. These held that, due to the abstract character of that type of relationship, an obligor under a promissory note could not make objections extracted from the underlying relationship, with few exceptions such as very grave and evident abuse of law. The Court found here that such abuse of law had taken place. The claimant should have known that it could not derive any right from the trade of weapons which underlined the promissory note. While such trade in itself was not against Swiss law, it violated Swiss *bonos mores*. First, it violated foreign[370] mandatory rules – the (then in force) UN embargo on the delivery of weapons to the territories of (now ex-) Yugoslavia – which constituted such fundamental legal principles that their violation was contrary to *bonos mores* from a Swiss point of view[371]. Second, under the concrete circumstances – a war between Croatia and Serbia – the underlying sale of weapons was contrary to the principle embedded in Swiss law and in international public law that weapons should not be delivered to territories in which an armed conflict or tensions probably leading to such were taking place, and since (regardless of whether the case was connected to Switzerland[372]) that principle was a part of the *bonos mores*, the sale was contrary to the latter. As it was considered immoral, the sale was void under Art. 20 (1) CO.

350 This subsuming of the foreign law (the UN embargo) under the *bonos mores* of the (Swiss) *lex causae* is in fact the material law approach. However, that method seems to have been implemented here unnaturally, as if trying to avoid having to apply the conflict of laws rule of Art. 19 PILA. This unnaturalness is visible, first, from the fact that a nuance of the conflict of laws approach remained – the concept of universal (in addition to the Swiss) public policy which is not part of the Swiss *lex causae* was used when *bonos mores* were defined (in fact, it is not clear why public policy was involved at all in defining

370 – for Switzerland, foreign, as the country was not a member of the UN at that time.

371 According to the Court, a condition for a violation of foreign mandatory rules to constitute a violation of morals in Switzerland was that the violated rules represented fundamental legal principles.

372 – with this note, the Court leaves the impression that it considers the said principle in its capacity as a Swiss, rather than an international, principle.

bonos mores – these are two different concepts – but the fact remains that the Court goes out of the borders of the *lex causae*). Second, superfluous arguments were used, probably because the judges were seeking to compensate (through providing as many arguments as possible) for some instability of the material law approach. In particular, the sale was not declared void already on the basis of it violating the international and Swiss principle that no weapons should be delivered into territories of actual or potential war, but also contradiction of that violation with *bonos mores* was argued – which is unusual, because already the violation of a principle of the *lex causae* (present here[373]) must render a sale null, and Art. 20 CO also contains the ground of illegality (apart from that of immorality) of the contract's performance.

5.3 SCHNYDER's proposal for subsidiary use

Whilst continuing to consider it inadequate for the consideration of foreign law, SCHNYDER suggests that the material law approach serves as an «exceptional or subsidiary remedy … where the special conflict law does not sufficiently observe the parties' interests touched upon in a particular case»[374] (it seems that for the author the special conflict law observes sufficiently the parties' interests when it defines the involvement of these interests as one of the criteria for connecting[375] – as Art. 19 PILA in its German and Italian versions does). Such subsidiary use of the material law approach is a good compromise, reflecting both the theoretical inaccuracy and the practicality of the approach. 351

III. «Avoiding the problem»

1. Characteristics

Often adjudicators (both international arbitrators and state judges) who examine an arbitration case attempt to avoid dealing with the concept of overriding 352

[373] – it is present since except international, the infringed principle is a Swiss principle and Swiss law is the *lex causae.*

[374] SCHNYDER, Wirtschaftskollisionsrecht, 315 (especially the last paragraph), 352, 353, own translation from German.

[375] SCHNYDER, Wirtschaftskollisionsrecht, 353, *passim*, e.g. in the third paragraph of point 9.) of «Gesamtzusammenfassung in Form von Leitsätzen und Thesen» (p. 439).

mandatory rules. That is not really a solution and is thus not a «method» (in the proper sense of the word) for treating overriding mandatory rules. However, one cannot blame the judiciary too much for this approach, since the described lack of express conflict of laws legislation leaves it with few alternatives. Especially when they adjudicate out of a civil law jurisdiction such as Switzerland, where objective law constitutes a very important source of criteria for a judicial decision, the absence of explicit conflict of laws rules is very cumbersome for adjudicators. This is so even for international arbitrators, who have more freedom in general, as when it comes to conflict of laws issues they are still bound by objective law (in particular by the *lex arbitri*).

353 Logically and similarly to the material law approach, the avoiding of the concept of overriding mandatory rules is performed only where the conflict of laws approach does not function.

354 The material law approach, in fact, also represents «avoiding the problem» – it is nothing other than an example of giving the problem another name[376], which is one of the forms of avoiding the problem discussed in 2.1 below. That is also why it was possible to give judgment *DSC 118 II 193* as an example of a judgment in which the adjudicators gave the problem another name (see 2.1, a. below) and at the same time to give one argument from that judgment as an example of the use of the material law approach (see Chapter 17., II., 4.3). However, since it reveals a certain typology – avoiding through the application of material law norms of the *lex causae* – and since it is the most used of all ways to avoid the problem, the material law approach is here analysed autonomously from the approach of avoiding the problem.

2. Forms and cases

2.1 Giving the problem other names

355 Very often the case is put into the framework of another concept which is less controversial for international arbitration than that of overriding mandatory rules – e.g. jurisdiction. Even if sometimes leading to a successful outcome,

[376] – i.e. not the sole case of giving the problem another name (other examples are given in 2.1 below).

such an approach is not sustainable in the long run, as it mixes different concepts.

a *DSC 118 II 193*

In *DSC 118 II 193*, one of the parties argued that a contract was incompatible with Community competition law. By virtue of Community law, this Community competition law was a part of Belgian law which i.c. was the *lex causae*[377]. The arbitrator viewed themselves as incompetent to decide on the alleged incompatibility, for Community competition law had been public policy law. On a challenge of the resulting arbitral award, the Court ruled that the arbitrator had had jurisdiction to investigate the issue raised and that by refusing to do so they had wrongly denied competence within the meaning of Art. 190 (2) (b) PILA. This case is an example of giving the issue of overriding mandatory rules, here overriding mandatory rules of the *lex causae*, another name – «competence». It is here deemed that Art. 190 (2) (b) PILA was not applicable to the arbitrator's rejection of competence to apply a law, since it did not cover such competence. It covered only the competence to resolve a dispute in a legally binding manner but not also the competence over the means for this resolving, amongst which namely the applying of and/or refusal to apply a law. The competence to resolve a dispute is present when the dispute is pecuniary and covered by a valid arbitration agreement, which was the case here. This competence is examined only in the beginning of the proceedings – indeed, Art. 190 (2) (b) PILA speaks of «declaring», which is an action typical for the outset of a legal procedure (during the middle and end of such a procedure, mostly constitutive actions are accomplished). In other words, one can here disagree with the opinion expressed by the Court in the third sentence of cons. 5, a) of the judgment that Art. 190 (2) (b) PILA envisages both competence in 356

[377] That Belgian law was the *lex causae* cannot be inferred from the official publication of the judgment – only from an unpublished part, which is printed in RabelsZ, Vol. 59, 1995, 309ff. – see p. 309 and 310 thereof (on p. 310, see in particular cons. 4, a)). Also SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 312, 313 (this work originally appeared in RabelsZ, Vol. 59, 1995, where the part of the judgment which was not in the official publication was printed), and MÖHLER, 714, fn. 900 rely on that unpublished part of the decision. They underline the fact that the invoked EU competition law was a part of the *lex causae*, as does IDOT, 982, para 12.

general to resolve the dispute and competence on separate points. It regulates solely the former; if it regulated also the latter, there would have been no need of Art. 190 (2) (c) PILA – *ultra petita* and *infra petita* would have represented wrongful declaring of competence and incompetence respectively and been submitted under Art. 190 (2) (b) PILA – or of Art. 190 (2) (e) PILA – the applying of a law that infringes the international *ordre public* would have constituted wrongful affirmation of competence within the meaning of the first hypothesis of Art. 190 (2) (b) PILA. Also, the literature criticises that Art. 190 (2) (b) PILA was not the proper legal basis for the judgment[378].

357 The Court seems to have resorted to Art. 190 (2) (b) PILA only because it wanted to give effect to the Community competition law but was lacking the means (not, as contended by the critics, in order to avoid application of Art. 190 (2) (e) PILA – the latter was anyway not applicable, as Community competition law did not represent international *ordre public*). The Court seems to have considered Community competition law a domestic *ordre public* of the Community – it cited an author referring to this law as to *ordre public* of the Community (cons. 5, c), bb))[379]. The Court could not impose application by the arbitrator of such *ordre public* of the *lex causae*[380] via Art. 190 (2) (e) PILA, since, as established, that article encompassed solely international (but not domestic) *ordre public* (as already mentioned, the view that Art. 190 (2) (e) PILA was the proper basis for the judgment is disagreed with here). Then, one might think that the judges could have had the arbitrator apply the Community competition law by relying on the latter's quality as the *lex causae*'s overriding mandatory law (this option being the reason this case is discussed here). This quality is present since (whilst whether overriding mandatory rules are at the same time domestic *ordre public* is not certain) it is certain that the

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[378] For instance, in the view of KARRER (who seems to consider overriding mandatory rules the same as positive *ordre public*) the Court in *DSC 118 II 193* was right in ruling that when a party relied on such rules, the arbitrator had to decide whether to apply or consider overriding mandatory rules; but was wrong in holding that not doing so constituted a violation of the jurisdictional provision in Art. 190 (2) (b) PILA – because jurisdiction had been different than applicable law – KARRER, BSK IPRG, Art. 187 N 236.

[379] See also the Court's later decision *Terra armata* (cons. 3.1, fourth paragraph).

[380] – as per Community law, the *ordre public* of the Community is also *ordre public* of Belgian law, which was the *lex causae.*

domestic *ordre public* rules (which here the Community competition law represents) are overriding mandatory rules of the respective law. However, the judges again did not possess the necessary ground in Art. 190 (2) PILA; also Art. 190 (2) (e) PILA (which the critics assert to be the provision that must have been applied) could not help, since it did not address overriding mandatory rules. And the problem was the lack of a rule on overriding mandatory rules, not in Chapter 12 PILA in general but in Art. 190 (2) PILA in particular; even if a rule in Chapter 12 PILA had obliged arbitrators to apply or consider overriding mandatory rules, the Court could not annul an award in which arbitrators had disobeyed this duty if Art. 190 (2) PILA did not foresee such disobedience as a reason for annulling.

Since in *DSC 118 II 193* this matter was given another name, the frequent pointing by the doctrine at the case as proof for applicability of overriding mandatory rules *legis causae* or of overriding mandatory rules in general is not correct. It is true that in a subsequent case – *Terra armata* (cons. 3.3) – the judges defined this infringing of Art. 190 (2) (b) PILA in *DSC 118 II 193* as infringing in relation to Art. 187 PILA; a provision which governs substantive law of which overriding mandatory rules make a part. However, that does not change the fact that, strictly seen, the judgment had dealt with jurisdiction, and not with overriding mandatory rules' applicability. In addition, for the reasons mentioned above, one does not agree that the proper ground for the decision was Art. 190 (2) (e) PILA. Even if it was, this would not have led to applicability of overriding mandatory rules by international arbitrators because this provision did not address this applicability. If any of the grounds under Art. 190 (2) PILA was to be invoked, that should have rather been the second hypothesis of Art. 190 (2) (c) PILA – one could argue that through refusing to scrutinise the contract against Community competition law, the arbitral tribunal left a *petitum* unadjudged. Even if it is seen to handle the treatment of overriding mandatory rules within international arbitration, as SCHNYDER underlines, *DSC 118 II 193* does not specify the conditions of such treatment or to what extent the Court itself (within challenge proceedings) would tackle overriding mandatory rules and, in fact, as SCHNYDER foretold in 1995 (the time of his publication), having regard to the restrictive Art. 190 PILA and the

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reserved jurisprudence of the Court, no great activism has been seen from the Court with regard to that complicated issue[381].

b *Case No. CC/2009/APP/0385, the Queen's Bench Division of the High Court of Justice, 30 October 2009*

359 Even though it originates from a foreign jurisdiction, one can mention the judgment of 30 October 2009 of the Queen's Bench Division of the High Court of Justice in *Case No. CC/2009/APP/0385*, reported in YCA, Vol. XXXV, 2010, 460ff., since it illustrates the trend discussed here – the giving of other names to the problem of overriding mandatory rules. This decision declared an arbitration clause null, viewing it as contradictory to mandatory (what is most probably meant is overriding mandatory) EU competition law protecting commercial agents inasmuch as the contract containing it incorporated also a choice of law clause in favour of Ontario law and through this prevented the applicability of the concerned EU provisions. The arbitrators had found that the choice of law and arbitration clauses were valid because the EU rules did not restrict the parties' freedom to choose applicable law. The English court felt that the EU mandatory rules had to be applied notwithstanding the parties' choice of another law. This opinion of the English judges is understandable. However, it is difficult to comprehend why they did not satisfy themselves with a ruling in this sense – a ruling that the arbitrators should apply the involved mandatory rules despite the choice of law – but, in addition, held that the arbitration clause was null, in this way denying the arbitrators' jurisdiction. Even if it had sought to, the arbitration clause could not prevent the application of mandatory EU provisions. This clause did not deal at all with the determination of applicable law, including mandatory law. It only provided for a forum. Determining the applicable law was done by another, separate clause – the choice of law clause. An arbitration clause and a choice of law clause have discrete subject matters – the former deals with jurisdiction and the latter with applicable law – which means that invalidity of one of them does not cause invalidity of the other. Besides, the invalidity of the choice of law clause i.c. should have been only partial, i.e. it should have concerned only

[381] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 324.

the issues regulated by EU law in an (overriding) mandatory manner, but not further matters.

2.2 Not addressing the problem

Sometimes adjudicators find a solution on a more general level at which overriding mandatory rules have not yet claimed applicability. 360

a *DSC 4A_520/2015 of 16 December 2015*

In *DSC 4A_520/2015 of 16 December 2015* banking mandatory rules (most probably banking overriding mandatory rules) which were invoked in international arbitration were deemed irrelevant and left undiscussed. The dispute related to a share and purchase transaction. Company X, a subsidiary in a banking group, was sold by company B to bank A. The Bank of Y and Z granted the necessary authorisations for the transaction under the condition that B recapitalised X. The respective share and purchase agreement («SPA») included an adjustment mechanism which had to be applied if such recapitalisation by B was to go beyond the demands of Y, and in particular if a certain ratio for assessing bank solvency was set by Y under 10%. According to that mechanism, A had to pay to B a particular ratio adjustment. Indeed, subsequently Y set the relevant ratio at 9%. In an ICC arbitration in Switzerland, B successfully claimed the ratio adjustment from A. One of the ways in which the latter defended itself was by claiming that the adjustment mechanism clause was invalid in view of mandatory rules, in particular of Z's guidelines and another unspecified provision of law. However, according to the arbitrators, the validity of the clause under those rules was irrelevant because Z, Y and other institutions had approved the transaction, including the disputed clause[382]. Hence, the tribunal deemed a «complex» analysis of the law applicable to the validity of the clause not decisive for the resolving of the case and did not proceed to it[383]. A filed an appeal with the Court alleging a violation of its right to be heard under Art. 190 (2) (d) PILA, since the arbitral tribunal had failed to examine its objection. The appellant claimed that the question of the approval of 361

[382] – citation of the arbitral award in cons. 3.1 of the Court's judgment.

[383] – again there: citation of the arbitral award in cons. 3.1 of the Court's judgment.

the transaction by the competent authorities was different from that of the compatibility of the clause with the respective mandatory rules and that in any case such authorisation of the transaction could not have cured a defect resulting from a violation of the public order. The Court found that there was no breach of the right to be heard, as the arbitral tribunal had specified the reason why it was not going into the issue of the clause's compatibility with public policy – because it viewed it as irrelevant. According to the Court, this clarification by the tribunal was equal to respecting the complaining party's right to be heard. The correctness of this (the tribunal's) statement – whether it could really be taken as granted that the issuance of the authorisations by the banking supervision authorities guaranteed the absence of a violation against the public order – was outside the scope of the review of the Court, so the latter did not provide its opinion on it.

362 Indeed, the legal ground on which the appellant based its challenge – a violation of the right to be heard – presupposes only the Court's check as to whether the arbitral tribunal addressed the appellant's arguments but not whether such addressing was correct or incorrect. Instead of or in addition to contending that the tribunal did not «hear» it on the compatibility of the contract's clause with the mandatory rules, the appellant could have complained about the tribunal's argument for not doing so (for not «hearing» it): in particular, it could have invoked the logic of the Court in the last sentence of *DSC 118 II 193*, cons. 5, c), bb) and contended that it could not have been irrelevant whether a contract's clause giving rise to a dispute was contrary to mandatory rules because incompatibility with the latter could have rendered such a clause invalid – and an arbitrator, when called upon to rule on the performance of a clause, needed to know if such clause was valid or not. The appellant could have further claimed that the principle of division of public powers rendered an authorisation of a transaction by an executive authority incapable of preventing a judicial authority (be it an arbitration or a state court) from scrutinising such a transaction against a law, especially against a law of a public policy character: if the judiciary is competent to scrutinise acts of the executive power directly (private law persons can challenge such acts in courts (in some countries there are also courts specialised in such procedures – administrative courts), *a fortiori* it must have the capacity to scrutinise administrative acts indirectly, by examining the compatibility with mandatory rules of a transaction authorised

through such acts. It is true that this proposed argumentation would not have rested on the overriding mandatory character of the rules concerned (but on Art. 190 (2) (b) PILA and Art. 190 (2) (c) PILA or both), but the appellant does not have many alternatives, keeping in mind that Art. 190 (2) PILA does not sanction incorrect treatment of overriding mandatory rules.

Whatever the outcome of the procedure for the annulment of the award rendered in it, this arbitration is an example of arbitrators' refusal to deal with overriding mandatory rules, and that is why it is mentioned here. VOSER is right in her comment that it would have been better if the arbitral tribunal had conducted the (in its view, complex) analysis of the law applicable to the validity of the clause. If after such analysis it had «…come to the same conclusion as with its first and main argument, there would probably have been a higher acceptance of the award by the parties and no reason to appeal it. If the public policy analysis had come out differently, this might well have prompted the tribunal to carefully balance the two outcomes against one another, which would lead to a more solid decision.»[384] One can add that the issue of public policy, given its complexity, is anyway difficult to evaluate without a «complex» analysis. 363

3. Evaluation

It is obvious that avoiding the problem is not a solution; it is avoiding a solution. As such, it cannot be supported. 364

IV. Opting for the conflict of laws approach

The avoidance of overriding mandatory rules is not a solution. The material law approach is not a long-term but only a temporary solution. The conflict of laws method is the proper solution in the long run, but it is currently «underdeveloped» because of the lack of conflict of laws rules in Chapter 12 PILA. In fact, it is this deficit that makes Swiss international arbitrators and judges turn to the material law method or the avoidance of the problem. Since this is 365

[384] VOSER, No violation of a party's right to be heard, 2.

considered to be the most suitable method, the conflict of laws approach is undertaken here – the following chapters should be read from its perspective.

Chapter 18: Chapter 12 PILA

The first «place» to search for conflict of laws rules regulating the treatment of overriding mandatory rules by Swiss international arbitrators is PILA's Chapter 12, as that is the *lex specialis* on Swiss international arbitration. The only articles of that chapter which deal with substantive law of which law overriding mandatory rules make a part are Art. 187 and 190. 366

I. Art. 187 PILA

Art. 187 PILA deals with «applicable law» (that is its title). Hence, first this provision is to be examined for potential stipulations on overriding mandatory rules. Art. 187 (2) PILA is to be excluded from the examination, since it does not refer to legal rules in the first place (only to non-legal considerations – such *ex aequo et bono*); this leaves Art. 187 (1) PILA. 367

1. Overriding mandatory rules *legis causae*

1.1 Uniform connection

PILA's Chapter 12, and in particular Art. 187 which makes the reference to this *lex*, does not feature an explicit rule on the uniform connecting of the *lex causae* as PILA's Chapter 1 in Art. 13 does. In fact, one could argue that such an explicit rule is not necessary, since uniform connecting of a law is accomplished merely through the interpreting of a reference to a law. Nevertheless, an express norm in Chapter 12 PILA would be useful, as it would lead to consistency with Chapter 1 PILA and more certainty (which is also why the proposal for new provisions made below includes such an explicit rule). 368

1.2 Special connection

KARRER has an idea to connect the overriding mandatory rules of the *lex causae* through the objective connection prescribed in the second part of Art. 187 (1) PILA[385], i.e. to qualify the overriding mandatory rules *legis causae* as «the law with which the disputed matter is most closely connected» referred 369

[385] KARRER, BSK IPRG, Art. 187 N 285.

to in the latter. This approach seems to be special connecting even though KARRER does not characterise it like that (or in any other way) because it implies the principal capability of the overriding mandatory rules of the *lex causae* to be subsumed under a conflict of laws rule (here the second part of Art. 187 (1) PILA) different than the conflict of laws rule under which the ordinary rules of the *lex causae* are subsumed (here the first part of Art. 187 (1) PILA), and that capability is present only where such overriding mandatory rules of the *lex causae* are regarded as a law separate from the ordinary rules of the *lex causae,* which is the case solely within the special connecting (under the uniform connecting, the overriding mandatory rules of the *lex causae* are considered to be one together with the ordinary rules of the *lex causae*).

370 However, the following speaks against such a course of action.

371 The exceptional nature of the special connecting of overriding mandatory rules *legis causae* renders their qualification under Art. 187 PILA inappropriate. First, the latter determines the law to govern the principal deciding of the case, of «the disputed matter», and not the law that governs the case only exceptionally and partially like the overriding mandatory law. Second, overriding mandatory rules that are connected through the special connection cannot be the law most closely connected to the case again because their relevance for the case is «exceptional» – if they were most closely connected to the case they would have been applied principally, not exceptionally. Admittedly, they would be connected (otherwise even their applicability by way of exception would not have been present); they would even be closely connected; but they would never be most closely connected. Solely the rules that govern the case principally would be most closely connected.

372 The second part of Art. 187 (1) PILA is subordinated to the first part of Art. 187 (1) PILA: it applies only «in the absence of a choice of law» – this choice of law is the hypothesis of the first part. The Italian version of Art. 187 (1) PILA additionally underlines such subordination by using the expression «in subordine» («subordinately»). This subordination means that the second part of Art. 187 (1) PILA can be applied only if the first part was not applied, and this means not applied at all, i.e. including not applied to a law different than the law to which one wants to apply the second part. Hence, connecting the

overriding mandatory rules *legis causae* through the objective connection under the second part of Art. 187 (1) PILA is possible only where no choice of law under the first part of Art. 187 (1) PILA was made. Keeping in mind that parties who submit their disputes to international arbitration often make such choices, this connecting would be rarity.

Then, if a choice of law was made, the chosen law (rather than just the overriding mandatory rules of the chosen law) would qualify as the law most closely connected to the case. Its choosing by the parties connects (to the case) a law in the strongest manner. (That is also why the legislator sets the closest connection of a law to the case as a criterium subordinate to the choice of law – if there is a choice of law, a search for the law most closely connected to the case is not needed because that law is the chosen law.) 373

2. Overriding mandatory rules of a third law

The overriding mandatory rules of a third law cannot be qualified under Art. 187 (1) PILA because they are a «third» law, i.e. a law different than that provided for by PILA, including by Art. 187 (1) PILA. That is evident with regard to the first part of Art. 187 (1) PILA – overriding mandatory rules of a third law are simply not chosen by the parties. However, it is true also in respect of the second part of Art. 187 (1) PILA, because if those rules are subsumed under the latter, they would cease to be overriding mandatory rules of a «third» law and become overriding mandatory rules of the *lex causae*. 374

3. Conclusion

It is possible to read the reference of Art. 187 (1) PILA to a *lex causae* as encompassing the overriding mandatory rules of the *lex causae* when the *lex causae* is connected to through the uniform connection. However, there is no explicit legal basis for the latter connection. 375

II. Art. 190 (2) (e) PILA

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Art. 190 (2) (e) PILA cannot be invoked to prove that overriding mandatory rules have to be applied or considered by an international arbitrator[386], since it deals with *ordre public* and, as was seen in Chapter 11, IV., *ordre public* is something different to overriding mandatory rules. Only the overriding mandatory rules that reach the level of *ordre public* can be subsumed under this provision, but that will happen on the basis of their *ordre public*, not their overriding mandatory, character.

III. Conclusion

377 Chapter 12 PILA does not expressly treat overriding mandatory rules. There is only a possibility to read Art. 187 PILA as encompassing the overriding mandatory rules of the *lex causae*. However, this is not based on an explicit rule but on a theory (that of uniform connecting to the *lex causae*). Consequently, a legislative gap, *lacuna*, which is a «true» gap[387], exists in Chapter 12 with regard to overriding mandatory rules.

[386] See also PFISTERER, Art. 190 N 86.

[387] – in SCHWANDER's terminology (SCHWANDER, ZGB Kommentar, Art. 1 N 6).

Chapter 19: Chapter 1 PILA as *lex generalis*

Since the part of PILA which is specialised in international arbitration – Chapter 12 – does not contain conflict of laws rules on overriding mandatory rules, one naturally looks at other chapters of the Act to see if they contain such conflict law rules and whether any such rules could be applied in an international arbitration procedure. 378

Chapter 1 PILA does so. Its Art. 13, 18 and 19 represent conflict of laws rules regarding overriding mandatory rules (whereby Art. 13 deals with the scope of a conflict of laws reference to *lex causae* in particular). Potential direct[388] application of these norms to international arbitration might be only in the form of application as *lex generalis*, i.e. according to the principle *lex specialis derogat legi generali*. (When an issue is not regulated in the *lex specialis* but it is in the *lex generalis* and such regulation by the latter does not contradict the characteristics which the issue manifests within the special situation, the *lex generalis* is applied[389].) It should first be proven that Art. 13, 18 and 19 PILA are general law. One might argue that they are valid for private international law procedures in general, i.e. for both international litigation and international arbitration dealing with private international law disputes; yet, that is not so clear from PILA – it might be that they concern only international litigation. Second, a gap in the *lex specialis* should be established. That will not 379

[388] – the indirect will be discussed in Chapter 21.

[389] That the solution of the *lex generalis* does not contradict the special characteristics manifested by the issue within the special situation is required because the application as *lex generalis* is direct application, hence, no adjustment to the special circumstances is possible (there is some indirectness in the fact that one first examines whether the *lex specialis* regulates the matter (since if it does, it would be the law to apply), but once confirmed the applicability of the general law is direct applicability). The logic behind the application as *lex generalis* is that the concerned issue when occurring in the special situation should be treated in the same way as it is treated when occurring in the general case because the specificities that have rendered the enactment of *lex specialis* necessary regard other aspects of the respective topic. The *lex generalis* is applied as it is – if one makes modifications to it then that would not be application as *lex generalis* but something else, e.g. application by analogy.

be difficult – Chapter 12 PILA does not regulate overriding mandatory rules. Last but not least, the solutions offered by Art. 13, 18 and 19 PILA will need to qualify as apt for international arbitration. This is far from being certain.

I. Legislative text

380 In order to find out whether Chapter 1 is applicable to the effect of overriding mandatory rules in international arbitration in a capacity of *lex generalis*, one should first consider the wording, structure and spirit of the legislative text. These three are to be studied together and as factors of equal significance. The grammatical interpretation of the law (i.e. the wording of the law), for example, should not have precedence over the other means of interpretation – Art. 1 (1) CC uses the preposition «or» («wording or interpretation»)[390]. At the same time, interpretation in accordance with the structure and spirit of the law cannot go against the latter's clear wording.

1. Wording

1.1 Pro

381 The strict interpretation of Chapter 1 PILA's wording might lead to the conclusion that this chapter covers the *ratio materiae* of the whole PILA, i.e. that it is a *lex generalis* for the individual special situations regulated by the different parts of PILA – such as the situation of international arbitration (regulated in Chapter 12). First, Chapter 1 PILA bears the title «General provisions». Second, its text – e.g. in Art. 14 (1), Art. 15 and specifically in the here relevant Art. 13, 18 and 19 – refers to a law designated by «this Act», and «this Act» includes Chapter 12 of the respective Act.

1.2 Contra

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390 «Under «law» one should understand in equal measure the wording and the interpretation of the law's wording. «Law» is the interpreted law.» – SCHWANDER, ZGB Kommentar, Art. 1 N 2, own translation from German. See also SCHWANDER, ZGB Kommentar, Art. 1 N 5.

Chapter 1 PILA uses too many times the word «court», which might be understood as a state court, particularly if it is interpreted *a contrario* to the wording of Chapter 12 PILA, which refers to an «*arbitration* court» (emphasis added).

2. Structure

2.1 Pro

First, the Swiss lawmakers regulated international arbitration in an act – PILA – in which they also regulated international litigation. If they had wanted to split international arbitration from international litigation completely, they would have regulated it through a separate law, as the UK legislator did (in the English Arbitration Act 1996). Next, it is not that only one of PILA's Chapters applies at a time. Some of them can and/or must apply cumulatively. Chapter 2 «Jurisdiction» and Chapter 3 «Applicable law» certainly apply simultaneously, since in an international litigation both jurisdiction and applicable law have to be determined. Thus, Chapter 1 and Chapter 12 must also be capable of being applied at the same time. Then, it is not an unknown legislative practice to place provisions which are more general and apply throughout a whole act into the first chapter of the act, even if this chapter is «only» equal to the other chapters. That is done for the sake of avoiding repetitions. Last but not least, whilst it is true that the fact that the legislator regulates some topics in both Chapter 1 and Chapter 12 means that the legislator wanted such topics to be addressed differently by state courts and by international arbitration tribunals (see the last argument in 2.2. below), that does not necessarily mean that the legislator wanted all topics to be subject to this different treatment. It means that it wanted this for the topics regulated in both chapters but not that it wanted it for the topics – like «overriding mandatory rules» – which are regulated only in Chapter 1; it might even be that the lawmaker regulated in both chapters solely the topics which it wished to be handled differently, and regulated only in Chapter 1 the topics which it wanted to be handled in the same manner (as there is no need to insert the same provisions in two places). 383

2.2 Contra

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First, the Swiss legislature appears to have wanted to treat international arbitration in an autonomous manner[391] because it separated the rules on the latter into an individual chapter. Second, Chapter 1 and Chapter 12 are equally footed in the hierarchy of PILA's norms, as they represent the same structural unit (a chapter) – from which one can assume that they exclude each other (i.e. that either Chapter 1 or Chapter 12 applies). Third, there are issues regulated in Chapter 1 and then again in Chapter 12, which means that the lawmaker did not want the same treatment of such matters in state and in arbitration courts – otherwise it would not have regulated the same topic also in Chapter 12 (there would have been no need for that). For instance, the recognition and enforcement of foreign judicial decisions is addressed in Sec. 5 of Chapter 1 but also in Art. 194 PILA within Chapter 12.

3. Spirit

3.1 Pro

385 It might have been that through leaving the status of overriding mandatory rules undefined by the *lex specialis* on international arbitration – Chapter 12 PILA – the legislature was submitting it to a *lex generalis*, as which Chapter 1 PILA could be perceived. The lawmaker could have simply seen overriding mandatory rules reveal no specificities, and hence need no special regulation, when arising within international arbitration.

3.2 Contra

386 On the other hand, overriding mandatory rules might have been «skipped» in Chapter 12 in order to let the international arbitration practice handle them. That is likely, since in most cases the Swiss *lex arbitri* (inspired also by international trends) seeks to leave to international arbitrators as much room as possible. If that holds true, there would be no space for application of Chapter 1 PILA as *lex generalis*, since the necessary intention would be missing.

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391 The literature speaks of «autonomy» of Chapter 12 – see, for example, GIRSBERGER/VOSER/COLACINO/DONCHI, 195 (the heading on the side reads: «Autonomy of Chapter 12»).

Another possibility is that, because of the private law focus of international arbitration, the lawmaker did not at all foresee overriding mandatory rules' becoming relevant in international arbitration. Here again, the legislator's intention for application of Chapter 1 PILA as *lex generalis* would be missing. 387

4. Conclusion

PILA is not clear on whether its Chapter 1 is *lex generalis* with regard to matters occurring within international arbitration which is (otherwise) regulated in its Chapter 12. 388

II. Case law

1. *Pro*

Although not keen on doing this and sometimes while not «admitting» it or even while denying it, international arbitrators and judges reviewing international arbitrations have sometimes applied Chapter 1 PILA as *lex generalis*. 389

The case examined *ad hoc* and available in ASA Bull., Vol. 24, Issue 3, 2006, 471ff., *Madame X v Madame Y, award from 19 June 2005* invokes Art. 19 PILA's concept of legitimate and manifestly outweighing interests[392]. Art. 19 PILA is mentioned expressly – in fn. 20. The fact that such mentioning is «solely» in a footnote does not change anything because, constituting from a linguistic perspective an integral part of a text, a footnote possesses the same legal value as the rest of such a text. 390

Chapter 1 PILA is relied on also in *K Ltd. v M S.A., ICC Award of 1989* in the context of bribes (ASA Bull., Vol. 11, Issue 2, 1993, 216ff., 231). Again, Art. 19 is pointed to. 391

In the international arbitration which was challenged before the Court in *DSC 4A_388/2012*, a CAS arbitral tribunal applied a non-Swiss (Bulgarian) man- 392

[392] In fact, it was found that i.c. such interests were not present and the taking into consideration of foreign imperative rules not required (ASA Bull., Vol. 24, Issue 3, 2006, 471ff., 477).

datory rule – Art. 19 (1) of the Bulgarian Civil Procedure Code – which excluded arbitrability of the (i.c. employment) dispute[393], despite being aware of the applicability of the Swiss Art. 177 PILA. The tribunal justified this, *inter alia*, with the fact that PILA allowed the consideration of foreign mandatory rules[394]. Such proceeding by the arbitral tribunal, i.e. including the relying on the permission by PILA for consideration of non-Swiss mandatory rules, was found by the Court inadmissible because of the mentioned Art. 177 PILA – the existence of a Swiss rule had meant that the respective issue had to be govern exclusively by this Swiss rule, including where the award's enforceability abroad would be threatened (which was the other concern of the arbitrators), and that a foreign rule could derogate from Art. 177 PILA only exceptionally where it (the foreign rule) was a part of *ordre public* (cons. 3.3). Apparently, for the judges, its mandatory nature was not sufficient to render a foreign rule capable of derogating from Art. 177 PILA[395]. The reliance by the arbitral tribunal in this case on the permission by PILA for the consideration of non-Swiss mandatory rules appears as an implicit application of PILA's Chapter 1 because such permission is contained in that chapter (Art. 13 and 19 PILA). In particular, it seems to be an implicit application of Art. 13 PILA because this article concerns overriding mandatory rules of the *lex causae* and the foreign rule i.c. was a part of the latter[396]. It is true that the Court rejected such implicit application as it rejected the application of the concerned foreign

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[393]The translation of Art. 19 (1) Bulgarian Civil Procedure Code used in the Court's decision (Sec. A.) reads as follows: «*The parties to a property dispute may agree that it be settled by a court of arbitration, unless the dispute has as its subject property rights or possession of immoveable property, alimony or rights as per employment relationship.*».

[394] «Facts», B., *in fine*, of the Court's judgment. The panel applied, not only considered, the Bulgarian mandatory rule – it regarded the latter as «applicable» («Facts», B. of the Court's judgment), even if it relied on a possibility given by PILA (only) to consider.

[395] In fact, at the end the award was upheld but on another (here irrelevant) ground – invalidity of the arbitration agreement.

[396] According to «Facts», A. where cipher 16 of the disputed (employment) contract is cited and to cons. 3.4.1 (even if the latter is not so firm on that since it uses the expression «in so far as») of the Court's decision, the law applicable to the main contract (and to the arbitration agreement) was Bulgarian law.

rule, but the case is brought here as an example that, when they consider themselves to be in a delicate situation (here due to inarbitrability under the *lex causae*), international arbitrators apply Chapter 1 PILA. It also holds true that the latter was implicitly applied to overriding mandatory rules on arbitrability, and not to overriding mandatory rules concerning substantive law, but the latter can be expected to be treated by international arbitrators analogically – an arbitral panel in another case (*ICC Case No. 8528*[397]) sees analogy: «The question of arbitrability is not in this respect different from the question at stake where the Arbitral Tribunal has to decide which is the applicable law to the merits of the case….» (para 32)[398].

2. *Contra*

The application of Chapter 1 PILA to international arbitration as *lex generalis* is, in any case, not stable. 393

When relying on Chapter 1 in *DSC 4A_388/2012*, the international arbitrators did not do so explicitly, which is a sign that the application of this chapter to international arbitration as *lex generalis* cannot function properly. The arbitrators did not base the invoked possibility for consideration of foreign mandatory law on Art. 13 PILA or on Chapter 1 PILA but on PILA generally (the Court's judgment, «Facts», B.). Most probably they were aware of the delicateness of the relationship between Chapter 1 and Chapter 12 PILA and did not dare to rely on Chapter 1's Art. 13 or more generally on Chapter 1. In addition, this decision demonstrates also that the Court is not cooperative in 394

[397] Application by analogy of Art. 19 PILA is mostly dealt with in para 25-39.

[398] In fact, it is here believed that the arbitral tribunal in *ICC Case No. 8528* did not prove this analogy, for example because one of the state courts' rulings on which it relied – «*Société La-binal c/ Société Moss et Société Westland Aerospace Ltd, Journal du Droit International (1993) p. 957*» (para 31 of *ICC Case No. 8528*) – did not at all deal with overriding mandatory rules on arbitrability (but only with overriding mandatory rules on, ironically, applicable law: it confirmed the preservation of arbitrability in the presence of relevance of such overriding mandatory rules on applicable law). However, this reasoning of the tribunal is here cited as an indication that international arbitrators see overriding mandatory rules on arbitrability and overriding mandatory rules on substantive matters as deserving analog -ical treatment.

establishing whether the possibility to consider foreign mandatory rules is open for international arbitrators. It did not address this problem directly but only implicitly – it stated that Art. 177 PILA, which i.c. the international arbitrators viewed as overridden by a foreign mandatory rule, could be derogated from only by *ordre public* rules, and it rejected *en blanc* the arbitral tribunal's decision on derogation (cons. 3). More elaboration on the role of the mandatory nature of the concerned foreign rule would have been more logical, especially since this nature was the main ground of the arbitral decision[399].

395 Then, naturally, the fact that there are other cases (to be discussed in Chapter 21 here) in which adjudicators apply Chapter 1 PILA to international arbitration only by analogy shows that there exist doubts with regard to direct application, hence, with regard to application as *lex generalis*. (As already contended, application as *lex generalis* is a type of direct application.)

3. Conclusion

396 Generally, the jurisprudence denies the applicability with regard to the problem of overriding mandatory rules (and any other applicability) of Chapter 1 PILA to international arbitration as *lex generalis*. It also tries to avoid the need for application. However, it sometimes (whether it admits this or not) resorts to the latter, being forced to do so due to the lack of regulation in Chapter 12 PILA.

III. Literature

1. *Pro*

397 Despite the principal rejection by the literature of any application of Chapter 1 PILA to international arbitration, similarly to the jurisprudence, some academics have resorted to such application. After not having obtained an answer from Chapter 12 PILA to the problem of the effect of overriding mandatory

399 In fact, the Court does not discuss much the potential (domestic) *ordre public* status of the foreign rule, which according to it could have led to derogation from Art. 177 PILA either, and this even though that status was claimed by a party (cons. 3.2, *in fine*).

rules in international arbitration, they started to look for help outside that chapter and arrived at Chapter 1 PILA because the latter is at least contained in the same act as Chapter 12 PILA.

KAUFMANN-KOHLER/RIGOZZI apply both Art. 13 and Art. 19 PILA to international arbitration without even debating the applicability or non-applicability of Chapter 1 PILA[400], and it seems[401] that they do so directly. 398

2. *Contra*

In SCHNYDER's view, international arbitrators are not strictly bound by the connections under the rest (apart from Chapter 12) of PILA provisions[402]. 399

Then, as much as they seem to be applying Art. 13 and 19 PILA directly, as contended in 1. above, KAUFMANN-KOHLER/RIGOZZI also cite authorities (the Court and the literature) which apply, for example, Art. 19 PILA by analogy, i.e. indirectly[403] – and they even do this right after the paragraph through which they left the impression of applying directly[404]. In addition, the authors want to take out from Art. 19 PILA the requirement for a Swiss concept of law, when that article is applied to international arbitration, which can solely happen within indirect application. 400

Most application*s* of Chapter 1 PILA to which scholars resorted took the form of application by analogy rather than direct application – a type of which application as *lex generalis* is. 401

3. Conclusion

The question on the capability of PILA's Chapter 1 of being applied to international arbitration and in particular to overriding mandatory rules becoming relevant in this type of dispute resolution is one of the eternal questions in the 402

400 KAUFMANN-KOHLER/RIGOZZI, 7.94.

401 – from the last sentence of this para 7.94 and the second sentence of fn. 162.

402 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 314.

403 KAUFMANN-KOHLER/RIGOZZI, 7.95.

404 KAUFMANN-KOHLER/RIGOZZI, 7.94.

literature. The general view is that international arbitration is regulated exclusively by PILA's Chapter 12 so that direct application of Chapter 1 PILA (as well as of any other chapter of PILA apart from Chapter 12) is inadmissible[405].

IV. Further arguments *pro* and *contra*

1. *Pro*

1.1 Cases of application of other provisions that are situated outside Chapter 12 PILA apart from Chapter 1 PILA's provisions on overriding mandatory rules

403 There exist cases in which rules that were situated outside Chapter 12 PILA and were not the rules of Chapter 1 PILA on overriding mandatory rules – rules of Chapter 1 PILA that dealt with other (than overriding mandatory rules) topics, rules of Chapters 2 to 11 PILA and rules of acts other than PILA – were applied to international arbitration. This might be evidence that for international arbitration PILA's provisions which are outside Chapter 12 are general provisions, hence, that for international arbitration the provisions of PILA's first Chapter are general provisions. At any rate, it shows that the «sovereignty» of PILA's Chapter 12 over international arbitration is not sacred – or at least that its sanctity has been encroached on (apparently, when there is a need, there is readiness to accept a solution contained outside this chapter). And if an exception was made for some, it must be available to others.

a Application of rules of Chapter 1 PILA that dealt with other (than overriding mandatory rules) topics

404 Chapter 1 PILA's Art. 1 (1) (e), for instance, certainly applies to international arbitration – it renders PILA applicable to the latter.

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[405] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 314 as well as many others an overview of whose opinions is provided in CHRISTEN, 19; VOSER, Vorlesung, slide 130 (arbitral tribunals do not have to apply the conflict of law rules applied by courts «in order to determine the applicable law»).

Then, before a special rule on this was inserted into Chapter 12 in 2006 – Art. 186 (1bis) PILA – the Court had considered that the *lis pendens* rule of PILA's first chapter – Art. 9 PILA – was applicable to international arbitration – *DSC 127 III 279 of 14 May 2001*.

Further, no one doubts that the reference in Art. 187 (1) PILA to a law covers only the substantive provisions of such a law. However, neither that article nor any other in Chapter 12 PILA explicitly indicates this[406]. Hence, some other rule must have been consulted. This rule cannot be anything else but Art. 14 PILA because this is the only provision in PILA which deals with *renvoi*. Moreover, the acceptance that there is no *renvoi* in Art. 187 (1) PILA corresponds to the solution of Art. 14 PILA: the latter prohibits *renvoi* with two exceptions – where PILA expressly refers to *renvoi* and where, in the area of family and personal matters, the *renvoi* points to Swiss law (Art. 14 (2) PILA) – and, since Art. 187 (1) PILA does not fulfil the hypothesis of either of these two exceptions (it neither provides explicitly for *renvoi* nor leads to the application of Swiss law in family and personal matters[407]), *renvoi* is prohibited. 406

b Application of rules of Chapter 2 to 11 PILA

Effectively Art. 154 (1) and 155 (c) of Chapter 10 PILA were applied in the international arbitration under scrutiny in *DSC 4A_414/2012 of 11 December 2012* (see «Facts», C. of the judgment). 407

Then, the arbitrators in the international arbitration examined in *Vivendi Elektrim* applied Art. 154 and 155 PILA (*Vivendi Elektrim,* «Facts», cons. B.c). What is more, as per the judgment, the arbitrators resorted to these provisions as to «general» conflict of laws rules of PILA (*Vivendi Elektrim,* «Facts», cons. B.c; own translation from German). In addition, also the Court applied the articles (*Vivendi Elektrim,* cons. 3.2). It should be admitted that the role of this Court's decision for the ensuing practice is questionable because the fact that it was not published in the official court reporter suggests that it was not 408

406 – unlike Sec. 46 (2) of the English Arbitration Act 1996, which addresses *renvoi* (at least) for the *lex causae* chosen by the parties.

407 – family and personal matters are anyway not even arbitrable because they are not pecuniary (Art. 177 PILA).

intended to be relied upon as a *décision de principe*. Nevertheless, the case shows that, when PILA does not offer them any alternative, international arbitrators and judges ruling upon international arbitrations have a recourse to PILA's provisions outside Chapter 12.

c Application of rules of acts other than PILA

409 Not only rules other than the rules of the first chapter of PILA, which dealt with overriding mandatory rules, and rules other than the first and the twelfth chapters of PILA, but even acts other than PILA acts are applied to international arbitration. For instance, currently the Federal Supreme Court Act of 17 June 2005 is considered as the legal basis for revision of international arbitral awards. The recently proposed bill on changes in PILA's Chapter 12[408] introduces such revision (Art. 190a), but that is still in draft form only.

2. *Contra*

2.1 Inappropriateness of some solutions of Chapter 1 PILA for international arbitration

410 Chapter 1 PILA's rules on overriding mandatory rules might contain solutions that are incompatible with the way overriding mandatory rules «behave» within international arbitration and are thus incapable of being directly applied within the latter[409]. One example is the Swiss point of view in Art. 19 PILA. Another is the priority granted to Swiss, as compared to non-Swiss, overriding mandatory rules, visible from the separate treatment – respectively in Art. 18 PILA, on the one hand, and in Art. 13 and 19 PILA, on the other[410].

2.2 Parties' reference to Chapter 12 PILA

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[408] Bundesgesetz über das Internationale Privatrecht (IPRG), Änderung vom …, Entwurf, 2018-1229, BBI 2018, 7213ff.

[409] In the case of overriding mandatory rules, the different starting points of a state court and an arbitration court do not allow automatic application to international arbitration of the concepts adopted for state courts – CHRISTEN, 20 and fn. 112 there.

[410] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 316.

It could be that the parties refer expressly to Chapter 12 PILA. For instance, the international arbitration scrutinised by the Court in *DSC 118 II 193* was submitted «*à la convention des Parties et à la loi fédérale du 18 décembre 1987 sur le droit international privé (chapitre 12 sur l'arbitrage international)*» (*DSC 118 II 193*, cons. 5, c), aa)). It is questionable whether such special mentioning of Chapter 12 PILA incorporates the will of the parties that their arbitration is governed exclusively by this chapter without any other chapters of PILA or «just» a principal indication of which the most relevant part of PILA is.

2.3 International trend towards independency of international arbitration laws from the rest of the seat's laws

Independence of Chapter 12 PILA from the rest of the PILA chapters would correspond to the international expectations towards modern arbitration law. 412

2.4 Chapter 1 PILA does not regulate all issues

Applying Chapter 1 PILA would anyway not be a *panacea*, as that chapter does not contain all answers. For instance, it does not address the consequences of application or consideration of overriding mandatory rules. 413

V. Conclusion

The admissibility of the application of Chapter 1 to overriding mandatory rules in international arbitration as *lex generalis* cannot be proven with certainty, and it seems to be unacceptable. 414

Chapter 20: Conclusion

415 Chapter 12 PILA does not regulate overriding mandatory rules relevant in international arbitration, and Chapter 1 PILA cannot be applied to them as *lex generalis*. Hence, there is a gap in the law (*lacuna*).

Subpart 3: New solution

The legislative gap that exists with regard to overriding mandatory rules in international arbitration can be addressed, in the first place, through application by analogy – statutory or legal analogy. This is a frequent method of closing legislative gaps and the one usually started with[411]. 416

Application by analogy is of two types – statutory analogy and legal analogy. Statutory analogy has priority; legal analogy is used only if statutory analogy is impossible, i.e. when there is no legal provision regulating a factual situation similar to the factual situation with respect to which a legislative gap exists. Statutory analogy (*analogia legis*) is the *mutatis mutandi* application of a legal provision which covers a factual situation similar to the factual situation regarding which a legislative gap exists to the latter factual situation[412]. The application should be *mutatis mutandi* since one needs to compensate for the differences between the factual situation for which a legislative gap exists (and to which the concerned legal provision is applied by analogy) and the factual situation to which the concerned legal provision applies in principle – such differences exist because whilst similar, these two factual situations are not identical. In the case of legal analogy (*analogia iuris*), the regulatory content of more than one legal provisions which are related to each other (because they treat the same topic, form a branch of law or even represent the whole positive law) is applied to the factual situation with respect to which a legislative gap exists; in particular a general principle is extracted from the spirit of this regulatory content and is applied to this factual situation. In this type of *analogia*, adaptations are not necessary because the principle that is being applied (by 417

[411] THURNHERR, 690, in another context (application of civil procedure rules to administrative procedure), states that the application of other rules by analogy and the developing of law by the adjudicator (in her discussion – a judge) are general principles on the filling of gaps. For her, the application by analogy is to be used before the development of law by the adjudicator – THURNHERR, 693. Also, VOSER, Lois d'application immediate, 79, 80 *in initio*, turns first to application by analogy (of Art. 19 PILA) when addressing the legislative gap she sees in respect of overriding mandatory rules of the *lex causae*.

[412] Amongst others, SCHLUEP, fn. 23.

analogy) has been adapted already during its «creation» – it has been extracted in a form in which it can be applied to the respective factual situation.

Chapter 21: *Analogia legis* of Chapter 1 PILA

I. Rules concerned

The rules of Chapter 1 PILA that have the potential to be applied by analogy to overriding mandatory rules in international arbitration are Art. 13 and 19. They namely deal with the destiny of overriding mandatory rules. Whilst it also addresses this destiny, Art. 18 PILA will have to be omitted, since it creates a privilege for the overriding mandatory rules *legis fori* which is incompatible with the international arbitration's conceptual distance from national laws, including from the seat's law, especially in cases of a neutral seat.[413] 418

Both Art. 13 PILA and Art. 19 PILA could be applied by analogy to overriding mandatory rules of the *lex causae*. If one wants to connect these rules through the uniform connection, one should apply by analogy the former. (In the view of the majority of authors, this provision implements that connection). Should one want to connect them through the special connection, it would be better to execute the *analogia legis* with Art. 19 PILA. If a choice must be made, Art. 13 PILA is preferable (and has been chosen here) because the uniform connection is less problematic. 419

To overriding mandatory rules of a third law, only Art. 19 PILA could be applied by analogy. It incorporates the sole possible connection for these rules – the special connection. 420

II. Admissibility

1. Similarity

Apparently, in order for *analogia legis* to be admissible, there should be similarity between the factual situation for which the legislative gap being filled exists and the factual situation which is directly covered by the rule to be applied by analogy. 421

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[413] MÄCHLER-ERNE/WOLF-METTIER, Art. 17, N 11; KARRER, BSK IPRG, Art. 187 N 256, 258.

1.1 Pro

422 Both when occurring in PILA's international arbitration and when occurring in PILA's international litigation, overriding mandatory rules concern international private law disputes. (Both types of legal procedures resolve this kind of dispute.) Then, in both cases, the topic arises in a procedure which is a means of delivery of justice[414]. Admittedly, international arbitration is a more flexible means (it does not feature many of the strict rules applicable in litigation), but it is still a means of delivery of justice and is, thus, based on the same fundament as state court proceedings are – the right to fair trial, the right to be heard etc. Furthermore, the differences between the two types of dispute resolution are not so great as to be incapable of being compensated for through the modifications that anyway accompany every application by analogy.

1.2 Contra

423 On the other hand, one can argue that even if they both represent mechanisms for the delivery of justice, PILA's international litigation and international arbitration are alternative mechanisms (to each other), and the similarities between them are not sufficient to render the solution regarding overriding mandatory rules adopted for the former apt for the latter.

2. *Analogia legis* is the primary means of overcoming legislative gaps

424 As mentioned above, application by analogy is given priority amongst the means for filling gaps, and *analogia legis* is given priority between the two types of *analogia*.

3. What is not enough for direct application might be enough for indirect application

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414 Also arbitrator Judge Lagergren talks about «the machinery of justice» meaning both state courts and arbitral tribunals: «…Parties who ally themselves in an enterprise of the present nature must realise that they have forfeited any right to ask for assistance of the machinery of justice (national courts or arbitral tribunals) in settling their disputes.» (emphasis added) – an arbitral award referred to in MISTELIS/BREKOULAKIS, 4, fn. 11.

Whilst the direct application of Chapter 1 PILA as *lex generalis* could not be proven (see above), some sense in it was seen. This renders the probability high that indirect application of this chapter, such as application by analogy, would be admissible – what is not enough for the more intense effect might suffice for the less intense effect. (Also, in contract law, a contract which is not concluded in the stricter, obligatory form is sometimes qualified as another type of contract, the form required for which it complies with – for example a «sales» contract for the transfer of a real estate property entered into in a written, and not in the necessary notary, form is treated as a preliminary sales contract.)

4. Application by analogy of other (than Chapter 1's) rules of PILA which are also outside Chapter 12

Application by analogy to international arbitration of the rules of Chapter 1 PILA on overriding mandatory law should be admissible also because other rules outside Chapter 12 PILA apart from them are already applied by analogy to that procedure. An example is the use of a solution with regard to the formal validity of a choice of law agreement which coincides with the solution of Art. 116 (2) PILA – the agreement is valid where it is made expressly, tacitly or by conduct[415]. Then, international arbitrators sometimes apply by analogy provisions outside Chapter 12 PILA in order to «concretize» Art. 187 PILA, for example in order to construct the latter's objective connection, which was moreover approved by the Court in an *obiter dictum*[416] [417], and this even if Art. 187 PILA is «the only provision that arbitrators need to consider to determine the applicable substantive law»[418]. 426

5. Lack of alternative

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[415] GIRSBERGER /VOSER /COLACINO /DONCHI, 1386.

[416] GIRSBERGER /VOSER /COLACINO /DONCHI, 1414 and the case cited therein.

[417] GIRSBERGER /VOSER /COLACINO /DONCHI, 1414 consider that proceeding is «justified» because the objective connection under Art. 187 PILA – the law most closely related to the case – is encountered in other parts of PILA and, as a matter of fact, is a basic principle behind all the Act's conflict of laws rules.

[418] GIRSBERGER/VOSER/COLACINO/DONCHI, 1413.

With Chapter 12 PILA being completely silent on the matter, one does not have much choice but to turn to Chapter 1 PILA, and since the latter's direct application is not an option, its application by analogy remains. It is easy to say that the provisions outside Chapter 12 PILA do not apply in international arbitration when solutions are available in that unit of PILA – e.g. it is easy to say that Art. 116 and 117 from Chapter 9 PILA, which govern the law applicable to a contract, do not apply when Chapter 12 PILA has Art. 187 which regulates such law. But where the matter at stake, like that of the effect of overriding mandatory rules, is not clarified in Chapter 12 PILA, things become more difficult, and resorting to chapters other than the latter becomes less of a «sin».

6. Urging and complex nature of the problem

428 The problem here is of an urging nature (*overriding* mandatory rules). In fact, the current work would not have proposed the approach of resorting to Chapter 1 PILA but would have favoured directly the adoption of new rules suggested below, if it was not for this nature. In addition, the matter is complex – it involves oppositive principles such as the private law nature of international arbitration and its public law function to deliver justice; the principle of parties' autonomy and the need to respect rules serving the general interests; etc. In such a situation, one should be prepared to accept solutions that are not ideal.

7. Case law

429 Though not keen on doing so, in some cases international arbitrators and state courts have effectuated application by analogy of Chapter 1 PILA – in fact, it was one of the most frequent conflict of laws instruments used by them for counteracting the gap.

430 For instance, the Swiss arbitral tribunal in *ICC Case No. 8528* examines and applies Art. 19 PILA by analogy to a third mandatory tax law[419]. The tribunal

[419] The application by analogy of Art. 19 PILA is mostly dealt with in para 25-39.

talks about applying the principle contained in Art. 19 PILA, not about applying the article, and it even expressly characterises the application as such by analogy[420].

The application by analogy of Chapter 1 PILA is more often application by analogy of Art. 19 PILA than of Art. 13 PILA. That is probably due to the fact that the latter's content is not unambiguous[421] and the fact that adjudicators feel themselves less obliged to point to a particular legal basis when applying the overriding mandatory rules of the *lex causae* than when considering overriding mandatory rules of a third law. 431

8. Literature

Academics often used Chapter 1 PILA's solutions, which cannot be anything but application by analogy of this chapter. Similarly to the jurisprudence, the literature resorts more often to *analogia* with Art. 19 PILA[422] than with Art. 13 PILA, again due to the greater need to justify the giving of effect to a third law's overriding mandatory rules than the application of overriding mandatory rules *legis causae*. 432

For instance, SCHNYDER (even if pleading for the connecting of overriding mandatory rules *legis causae* through a newly built special connection which would be valid for all – overriding mandatory rules of a third law, overriding mandatory rules of the *lex fori* and overriding mandatory rules of the *lex causae*[423]) seems to admit a possibility for application of Art. 13 PILA by analogy. He talks about the possibility to «fructify the thought» from the latter (by which, in his view, this article would come «to the arbitration law provision 433

420 See e.g. para 25 (point II.), para 33 and 33 (b) in particular.

421 It seems that also for SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 314 that is one reason not to «fructify» Art. 13 PILA's idea of comprehensive application of the *lex causae* in international arbitration.

422 For an overview e.g. of the literature on potential application by analogy of Art. 19 PILA, see KARRER, BSK IPRG, Art. 187 N 263.

423 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 314.

on applicability of Art. 187 PILA as concretization»)[424]. Further, he suggests the «considering» within international arbitration of Art. 19 PILA according to «its principal regulation and connection intention», «not in the form in which it became a law»[425]. In fact, it is not clear whether by such considering, he means application by analogy of Art. 19 PILA or embedding of the latter's solution into the special connection which he proposes – but in any case, he appears to deem the former possible. In addition, he states that it is «thinkable and even probable» that a rule like Art. 7 Rome Convention (at that time in force – today Art. 9 (3) of Rome I) or Art. 19 PILA be fructified above all by arbitration[426].

434 KAUFMANN-KOHLER/RIGOZZI, 7.96-7.101 seem to apply Art. 19 PILA by analogy as well, even if that is not so clear since (as discussed above in Chapter 19, III., 1.) at another place they appear to apply it directly[427].

435 KARRER raises the questions: «…Art. 18, 19 by analogy?...»; «…Art. 15 by analogy?...»; «…Art. 18 by analogy?…»; «…Art. 19 by analogy?...»[428]. He sees Art. 19 PILA as applicable with «substantial modifications»[429].

436 GIRSBERGER/VOSER/COLACINO/DONCHI seem to be against Chapter 1 PILA's application by analogy. With some sort of an *a contrario* logic, they read the fact that Art. 18 and 19 PILA explicitly limit the parties' choice of law as «an indication that any limitations to the principle of party autonomy in arbitration must be considered with caution, in particular where the parties have expressly

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[424] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 313, 314, own translation from German.

[425] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315 (*in fine*), 316, own translation from German.

[426] SCHNYDER, Wirtschaftskollisionsrecht, 340, own translation from German.

[427] At KAUFMANN-KOHLER/RIGOZZI, 7.94, last sentence and fn. 162, second sentence.

[428] Parts of the titles of, respectively, heading «a», heading «aa», heading «bb» and heading «cc» in KARRER, BSK IPRG, Art. 187 N 256-284.

[429] KARRER, BSK IPRG, Art. 187 N 256.

chosen the law applicable to the substance of their dispute»[430]. This interpretation was supported through the wording and history of Art. 187 PILA as well as through the existence of the possibility for the parties, by agreeing on having the decision rendered *ex aequo et bono* under Art. 187 (2) PILA, to cause the international arbitrator not to consider any law at all[431].

All in all, different voices are «heard» in the doctrine, but the majority are in favour of application by analogy; most probably since no other way out is seen. 437

III. Appropriateness

1. *Pro*

1.1 Compromise

Application by analogy of the conflict of laws rules of Chapter 1 PILA would come as a good compromise between the signs for applicability as a general law of Chapter 1 PILA and the legislator's will to regulate the arbitration under Chapter 12 PILA differently than the litigation under Chapter 1 PILA. 438

1.2 Adaptability

Application by analogy allows adaptation to the particulars of international arbitration. The necessary adjustments to Art. 13 and 19 PILA can be undertaken and Art. 18 PILA can be left «un»applied. 439

2. *Contra*

2.1 Too many adaptations necessary

While adaptations go along with application by analogy, one cannot make too many adaptations since that would not be application by analogy but application of new rules. 440

2.2 No rule on consequences

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[430] GIRSBERGER/VOSER/COLACINO/DONCHI, 1393.

[431] GIRSBERGER/VOSER/COLACINO/DONCHI, 1393 and the references there.

Another argument against application by analogy of Chapter 1 PILA is that the latter does not contain rules that govern the consequences of giving effect to overriding mandatory rules. Hence, it does not offer comprehensive regulation of overriding mandatory rules anyway.

IV. Temporary solution

442 Because there is another, better solution – the adoption of new explicit rules – it would be the best to apply by analogy Chapter 1 PILA's conflict of laws rules only temporarily.

V. Conclusion

443 Application by analogy of Chapter 1 PILA's conflict of laws rules that regulate overriding mandatory rules for state courts is a possible way to fill the *lacuna* existing with regard to overriding mandatory rules in international arbitration. However, it is not an ideal solution. That is why it is appropriate only as a temporary measure.

Chapter 22: *Analogia iuris*

Since *analogia legis* did not turn out to be an ideal solution, one can attempt to address the problem through *analogia iuris*. The latter will consist of extracting conflict of laws rules on overriding mandatory rules from the general principles of international arbitration law and of law in general. 444

I. Right to give effect to overriding mandatory rules

1. Ordinary limitation of freedom of contract

Giving effect to overriding mandatory rules within international arbitration is nothing odd. It is equal to limiting the parties' freedom to agree on the substantive law applicable in the international arbitration[432], and since this freedom is a sort of a freedom to contract, it can be limited in the same way as any freedom to contract can be limited, which is in the name of the interests of others – Sec. 1 (b) of the English Arbitration Act 1996, for example, states: «the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest». 445

Hence, the giving of effect to overriding mandatory rules by the international arbitrator does not mean that he or she fails to respect the parties' freedom to contract but only that the latter was limited for the sake of public interests – those public interests which are protected by the overriding mandatory rules in question[433]. As in any other private law transfer of rights, the parties cannot transfer to the arbitral tribunal more rights than they themselves have[434] – if their freedom to choose applicable substantive law was limited by overriding mandatory rules, then the circle of substantive law norms which an international arbitrator could determine as applicable will also be restricted. 446

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[432] It was discussed also above in connection to mandatory rules in general that the effect of those rules is to limit the freedom of contract.

[433] See also CHRISTEN, 21.

[434] CHRISTEN, 23.

2. The essence of overriding mandatory rules as suppressing the applicable law

447 The very essence of overriding mandatory rules consists of them suppressing the law applicable to the case (they are to be applied or considered regardless of the latter law). If this power is the core of their nature, they must possess it while in any type of legal procedure, including in international arbitration[435].

3. Prohibition of a parties' stipulation that solely the contract regulates the relationship between them

448 An argument in favour of an arbitrator's right to give effect to overriding mandatory rules can be the rejection by most authors of the possibility that the parties exclude the effect of any other rules of law outside the contract by stipulating that the latter is the only document regulating the relationship between them[436]. What is actually feared here is that rules of law which have to be applied or considered in any circumstances – such as overriding mandatory rules – remain unapplied or unconsidered. It would make no sense to try to ensure the application or consideration of overriding mandatory rules and at the same time to prohibit it.

4. Private law persons can also participate in the establishment of new policies

449 DALHUISEN defends the right of arbitration to take part in the process of establishing new policies, i.e. to apply new policies, including those in the quickly developing financial markets area. In his view, such a process is not «a government monopoly» and «in civil society it would be a sad day indeed if citizens had to wait solely for government (and their courts) to take action in these matters.»[437]

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[435] CHRISTEN, 26.

[436] GIRSBERGER/VOSER/COLACINO/DONCHI, 1362.

[437] DALHUISEN, Applicable Law, 7.105.

II. Obligation to give effect to overriding mandatory rules

The existence of a right to apply or consider overriding mandatory rules does not exclude the existence of an obligation in this regard – one can have a right and at the same time a duty to exercise this right. Proving an obligation is difficult here, since there are no legal sanctions for not applying or not considering overriding mandatory rules; non-legal «sanctions», such as non-appointment of the arbitrator in future cases, are possible, but do not prove the existence of a legal obligation. 450

1. Inherent in the task of international arbitration to resolve a dispute

One can make the case that the application or consideration of overriding mandatory rules is inherent in the very task of international arbitration to resolve the dispute. To do so, one can contend, means, *inter alia*, to subsume the case under the law that governs such a case (legal qualification), and this law might be, or include, overriding mandatory law[438]. If this subsuming is not executed, there will be a violation of the second hypothesis of Art. 190 (2) (c) PILA (*infra petita*). Thus, the international arbitrator needs to apply or consider overriding mandatory rules; not in order to protect some law (which, unlike state courts, he or she does not need to do) but in order to perform the very task with which he or she has been entrusted – to resolve the dispute. This all holds true even where the parties have chosen the applicable law and the latter is different than the overriding mandatory law, since the presence of such choice neither changes the fact that the international arbitration has been put into motion for the resolving of a dispute[439] nor «reduces» or «neutralises» the 451

[438] See also CHRISTEN, 22.

[439] CHRISTEN, 21, 22 seems to have a similar view: «Although the parties can choose on which legal order the arbitrator should base this judgement, the authorisation to settle the dispute, in my view, namely comprises that the arbitrator detects such overriding mandatory rules that want to apply to the facts of a case regardless of the law otherwise applicable, i.e. also regardless of a choice of law by the parties.»; own translation from German.

effect of overriding mandatory rules, as those are independent of the law principally applicable to the case.

2. Part of the merits

452 The application or consideration of overriding mandatory rules is a part of the deciding of the merits of a case, and the international arbitrator is the person called upon to perform this deciding. Hence, he or she cannot be anything other than obliged to conduct such application or consideration.

453 In the US case *Civ. 283 (GBD) (S.D.N.Y. March 04, 2013)*[440], the determination by arbitrators of applicable law and of applicability of overriding mandatory rules was found to be a matter of substance and thus a prerogative of arbitrators which was outside the court's review. In *Goldman Sachs International v Novo Banco SA [2015] EWHC 2371 (Comm)*[441], an English court ruled that the potential influence of a banking regulator's resolution measure on a loan could be examined only as part of the merits, and not as a question of jurisdiction (para 92, *inter alia*, in conjunction with para 89). In fact, here a state court was the holder of jurisdiction, but by analogy, the impact of a banking regulator's resolution measure on a loan must be qualified as a substantive issue also where competence was assigned to an arbitral tribunal.

3. International arbitration is a method for the delivery of justice

454 The private law nature of international arbitration does not reduce its function as a means for the delivery of justice. International arbitration is of a «hybrid

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[440] The controversy here originated from the financial sphere. The court was looking at a request for the vacation of an arbitral award rendered in an ICDR-AAA arbitration in which the Abu Dhabi Investment Authority complained that the value of its investment in Citigroup, Inc. was diluted by the latter (through the issuance of preferred shares to other investors and the converting of those shares to common stock) and that more favourable terms were conferred on other investors.

[441] Thanks are due to Mr. Tiago Ferreira de Lemos, an attorney at law, PLEN – Sociedade de Advogados RL, Lissabon, Portugal, for drawing the author's attention to this case.

nature»: it «is contractual because it derives from an agreement between the parties. At the same time, it is procedural or *adjudicative*, because it relates to a binding dispute resolution process.»[442]. It is here considered that sometimes the contractual side is focused on too much – international arbitration is thought of solely as a contract and its adjudicative nature is neglected. In fact, contracts only trigger the international arbitration (arbitration agreement) and define the procedural (agreement on procedural rules, agreement on an arbitrator, etc.) and the substantive (agreement on the choice of law) frame of the international arbitration, but they do not do the latter's job – the resolving of the dispute. The mandate from the parties to the international arbitrator is for resolving a dispute, and not for resolving a dispute in a particular manner[443]. Besides, if parties could agree on everything in international arbitration, they would be able to isolate themselves from the legislative domains of states, which the latter cannot have meant to allow[444]. Next, even if arbitrators do not represent a state, they accomplish delivery of justice – they are private law persons with public law functions, like, for example, notaries[445] – and the circumvention of overriding mandatory rules through exclusion of their applicability in international arbitration is disturbance to any delivery of justice.

4. Dependence on state legal orders

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[442] KAUFMANN-KOHLER/RIGOZZI, 2.05; emphasis added.

[443] CHRISTEN, 21 and fn. 120 thereof.

[444] When parties choose international arbitration, they choose who can resolve their dispute, but they do not exempt themselves from the domain of the state which enacts legislation obligatory for them – CHRISTEN, 22.

[445] For Guldener, as cited by GENTINETTA, 99: «With empowerment by law arbitration courts exercise official functions» (own translation from German). At the same time, one should note that the continuation of this statement («and therefore make part of the system of state courts») is not agreed with here: the fact that they accomplish activity of official character does not necessarily render arbitration courts part of the state judicial machinery – they would be performing such activity by reason of empowerment, and not because of belonging to the state apparatus.

International arbitration is possible only within the frames of legal orders[446]. Since in principle the state has a monopoly on the legally binding resolving of legal disputes, its authorisation is needed in order that someone else, such as an arbitral tribunal, resolves a dispute in a legally binding manner. Where it feels its legal order to be threatened by such an adjudicator, a state might decide to refuse to grant such authorisation. It might deem the disrespect for overriding mandatory rules as such a threat because those rules protect interests that are paramount to it. If this is the case, international arbitrators will need to apply or consider overriding mandatory rules in order to preserve their right to deliver justice.[447]

5. No space of illegality

456 International arbitration is no space of illegality[448]. That an international arbitrator is a private law person and that the parties to the dispute are conferred freedom to define many of the aspects of the procedure does not mean that the latter is «outside» the law. The legal order granting freedom to the parties and to the international arbitrator does not equal it allowing them to act outside it (and this is so with any freedom awarded to private law persons). An international arbitrator, in addition, performs a public law function – to deliver justice – which brings with it certain responsibilities.

5.1 No circumvention of law

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446 CHRISTEN, 26.

447 VOSER, Mandatory rules, 337. According to GIRSBERGER/VOSER/COLACINO/DONCHI, 1375 under certain circumstances arbitrators «must apply mandatory rules of third countries in the overall interest of arbitration since not doing so would lead in the longer term to states or a community of states such as the EU reducing the scope of arbitrable disputes». MAYER, 286 points out: «Although arbitrators are neither guardians of the public order nor invested by the State with a mission of applying its mandatory rules, they ought nevertheless have an incentive to do so out of a sense of duty to the survival of international arbitration as an institution.». Also, according to CHRISTEN, 27 the dependence of international arbitration on recognition by states brings with itself a duty to apply overriding mandatory rules.

448 See also CHRISTEN, 22.

The need for precautionary measures against circumvention of overriding mandatory law is greater in international arbitration than in international litigation, as some of its features – such as the strong bindingness to the parties' selection of law, the possibility to opt for confidentiality of the procedure, or the opportunity to agree that no reasons are stated in the award (Art. 32 (3) Swiss Rules, Art. 34(3) UNCITRAL Arbitration Rules) – can be misused for this purpose.

458 The general principle of prohibition of abuse of rights is to be invoked against circumvention of overriding mandatory law and of law in general[449]. In accordance with it, no one is obliged to enforce an act of abuse of law[450]. Thus, an international arbitrator can disregard a choice of law made with the sole purpose of circumventing an overriding mandatory law[451].

459 Then, in some cases, international arbitrators have some concrete tools to use against the circumvention of overriding mandatory law. For instance, the Swiss Rules (Art. 34 (1)), the ICC Rules (Art. 33) and the P.R.I.M.E. Finance Rules (Art. 37 (1)) subject the issuing of a consent award (an award on agreed terms) – an award which records a settlement reached by the parties – to the acceptance of such settlement by the arbitral tribunal[452]. Thus, where the latter finds that the respective arrangement violates overriding mandatory rules, it will be able to refuse to issue the consent award.

5.2 Unfair to force a party to break a law

460 It would not be just to force a party to break an overriding mandatory law by which they are bound even if that law is not the law that applies to the contract. That would be all the more so where consequences as heavy as criminal law sanctions are attached to the breach (as they were, for example, to the infringement of the Greek laws on capital controls from 2015).

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449 MÄCHLER-ERNE/WOLF-METTIER, Art. 177 N 18c *in fine*.

450 GIRSBERGER/VOSER/COLACINO/DONCHI, 1401; KARRER, BSK IPRG, Art. 187 N 250.

451 KAUFMANN-KOHLER/RIGOZZI, 7.30 with further references.

452 The Rules of the City Disputes Panel in London do not provide for such approving of the settlement.

5.3 Iura novit curia

461 The most obvious argument for recognising a duty to apply or consider overriding mandatory rules is the principle *iura novit curia*. According to it, an international arbitrator knows the law and is not limited to choosing from the legal qualifications made by the parties but is able to make new ones. In *4A_446/2013 of 5 February 2014*, the Court could, in fact, not be convinced that this principle led to an international arbitrator's duty to examine a provision (i.e. a rule *legis causae* on setting off a time-barred counterclaim) which was never raised by the parties. However, since (amongst other things) the Court saw it as relevant that the arbitration's terms of reference stated that the parties had to prove the applicable law's content, it is not excluded that in the absence of such terms, *iura novit curia* will be seen as activated.

6. Trend in legal instruments towards giving effect to overriding mandatory rules of a third law

462 The more legal instruments give effect to them, the more legitimate it is to give effect to overriding mandatory rules in international arbitration – the attention paid to them by legal instruments is an indication of their importance. Also, the arbitral tribunal in *ICC Case No. 8528* supports the solution of Art. 19 PILA of giving effect to a non-designated law's overriding mandatory rules with the fact that such solution is known to other conflict of laws systems – the Rome Convention (Art. 7), The Hague Convention of the Law Applicable to Agency of 14 March 1978 (Art. 16) or The Hague Convention on the Law Applicable to Trusts and on their Recognition of 1 July 1985 (Art. 16 (2))[453].

7. No benefits without obligations

463 Where overriding mandatory rules set conditions for the conferring of benefits, as in *ICC Case No. 8528* where conditions for the granting of tax benefits were prescribed, their application is a necessity if one wants to obtain the benefits.

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[453] – *ICC Case No. 8528*, para 28 and 29. In para 30, the tribunal concludes that «there exists a real trend in favour of a more open system whatever the difficulties may be in identifying the legal notion or vague provisions like interests, close connection, discretion given to the judge etc.».

This is so even where the relationship which the benefits concern is subjected to a law different than that which awards them. Whoever grants benefits to another party has the right to define the conditions for such granting.

8. Reconcilability of protection by overriding mandatory rules of public interests with protection by international arbitration of individual interests

8.1 Principal reconcilability of protection of public interests with protection of individual interests

Justice for individual interests and justice for public interests can function simultaneously. They do not exclude each other. That one is protecting individual interests does not mean that one is acting against public interests. It does not even mean that one is not acting to the benefit of public interests, since justice for individual interests might bring about justice for public interests. For example, in the case of private enforcement of a public law act, through implementing the latter in relations between private parties, its public law goals are also achieved; or, when one of the parties to a contract is released from performance because the law of the state in which it is incorporated prohibits such performance, not only the private interests of that party but also the interests of the mentioned state are protected[454]. 464

8.2 Reconcilability of protection by overriding mandatory rules of public interests with protection by international arbitration of individual interests, using the example of reconcilability of protection by financial overriding mandatory rules of the public interest in publicity with protection by international arbitration of the individual interest of the parties in confidentiality

a Publicity in finance

[454] See also SCHNYDER, Wirtschaftskollisionsrecht, 255, last paragraph as well as *ICC Case No. 8528,* para 27 where the tribunal states that, whilst PILA wants to create «a fair balance between the opposed interests of two individual parties...», «Art. 19 PILA may indirectly protect the interests of a certain country».

465 Financial regulations impose on publicly listed companies a duty to disclose certain information (e.g. Art. 958 (1) of the CO, Art. 212-13 of the French General Regulation of the Financial Markets Authority, para 20.8 of Annex 1 to EC Regulation 809/2004 of 29 April 2004[455]). This obligation serves the financial markets law's purpose of protecting financial markets participants through enabling them to make an informed decision whether to invest in such companies. The disclosure is accomplished on a regular basis through yearly reporting and/or *ad hoc* by press releases upon the occurrence of specific events. Since the end result of a legal procedure which concerns pecuniary matters influences the financial condition of a company, the presence of such a procedure comes within the scope of this disclosure obligation.

b Confidentiality in international arbitration

466 Even if confidentiality is not intrinsic to international arbitration (but needs to be expressly agreed on by the parties or provided for by law)[456], it remains a frequent choice in it.

c Reconcilability of publicity in finance and confidentiality in international arbitration

467 It has been feared that agreed confidentiality of international arbitration could hinder compliance with the financial markets rules requiring publicity. Under human rights law (Art. 6 (1) ECHR), privacy in arbitration is an admissible waiver of the right to public trial only where, amongst other things, it does «not run counter to any important public interest»[457] – and one can argue that privacy of financial transactions subject to international arbitration goes against such «important public interest».

468 On the other hand, complying with the obligation for publicity under financial markets law does not exclude abidance by a potentially existing duty to keep

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[455] This Regulation implements Directive EC 2003/71 providing for this disclosure.

[456] *Bulgarian Foreign Trade Bank Ltd («Bulbank») v A.I Trade Finance Inc («AIT»), Case No. T 1881-99, Judgment of the Swedish Supreme Court, Stockholm, 27 October 2000.*

[457] Para 66 of *Häkansson v Sweden (1990) 13 EHHR)* and the referring to it in *Osmo Suovaniemi v Finland (Decision as to the Admissibility of Application No. 31737/96* read together.

the international arbitration confidential. First, one could report only the existence, type of subject matter and approximate sum at stake (or even only the sum) without the concrete matter and the counterparty[458]. Second, often the very stipulation of confidentiality makes exceptions for cases where the exercise of legal duties or rights requires surrender of information. Disclosure required by financial legislation certainly qualifies as a case of the exercise of legal duties or rights requiring surrender of information[459].

At any rate, in case of a conflict, precedence should be given to the publicity requirement, since the latter safeguards public interests – those of investors, savers, etc.; the arrangement for confidentiality protects private interests – those of the parties to the international arbitration. Also, the Groupe de Travail which rendered *Rapport Final* supposed that the objective of protecting savings and investments would prompt a French state judge or arbitrator to view Art. 212-213 of the French General Regulation of the Financial Markets Authority or a foreign rule on publicity as a *loi de police*[460]. 469

9. The duty under Art. 42 ICC Rules to endeavour to deliver enforceable awards cannot prove an obligation

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458 In that sense, also *Rapport Final*, 67 and the therein (in fn. 69) cited piece of work. Also, MAZURANIC /FAVRE (4.2, last paragraph) seem to consider that confidentiality and publicity, in particular publicity that contributes to case law, can live together.

459 E.g. Art. 44 of the Swiss Rules provides for confidentiality only «except and to the extent that a disclosure may be required of a party by a legal duty, to protect or pursue a legal right, or to enforce or challenge an award in legal proceedings before a judicial authority» (Art. 44 (1) Swiss Rules). The ISDA/IIFM Tahawwut Master Agreement provides in its Sec. 13 (c) (iii) for an exception from the confidentiality principle in cases where a legal duty or the protection or pursuit of a legal right urges upon a party to disclose information. An example of an individual agreement that anchors exceptions to the confidentiality principle is the integration and investment Agreement between Mitsubishi UFJ Financial Group, Inc. and Morgan Stanley (Art. VIII «Miscellaneous», Sec. 8.2 (e) in connection with Sec. 3.3 (b) (exemptions for disclosures required by applicable law)).

460 *Rapport Final*, 68 and fn. 72.

The duty under Art. 42 ICC Rules to endeavour to make sure that the award is enforceable at law[461] cannot prove an obligation of Swiss international arbitrators to apply or consider overriding mandatory rules (even if relied on in *ICC Case No. 8528*[462]). This duty is one for efforts, not for a result, and one that covers only matters not governed by the ICC Rules. Even if it was for a result and it covered also matters regulated by the latter, the situation would not have changed. First, in order to be enforceable, an award does not need to observe overriding mandatory rules – it suffices that it respects the *ordre public*, and moreover only the international *ordre public* (Art. 190 (2) (e) PILA and Art. V (2) (b) New York Convention). Second, though it is true that in practice international arbitrators prefer to comply with rules which could influence the enforceability of their award, they do not have the opportunity to do so, as these rules are not known with certainty at the time of the award's delivery – the place of enforcement can be defined also after such delivery.

10. The internal procedure for control in ICC arbitration cannot prove an obligation

471 In an internal procedure designed by its internal rules, the International Court of Arbitration of the ICC can «draw [the arbitral tribunal's] attention to points of substance» (Art. 34 of the ICC Rules), where practicable, after considering the mandatory law of the place of the arbitration (Art. 6 of the Internal Rules of the International Court of Arbitration of the ICC (attached to the ICC Rules as Appendix II) in conjunction with Art. 34 of the ICC Rules). However, this scrutiny takes place «without affecting the arbitral tribunal's liberty of decision» (Art. 34 of the ICC Rules), and the required approval of the award concerns only the latter's form (Art. 34 of the ICC Rules, third sentence) so that no proof of a duty to apply or consider overriding mandatory rules can be extracted here.

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461 Art. 42 ICC Rules: «In all matters not expressly provided for in the Rules, the Court and the arbitral tribunal shall act in the spirit of the Rules and shall make every effort to make sure that the award is enforceable at law.».

462 Para 35 of that award refers to Art. 26 ICC Rules in which at that time the rule of the current Art. 42 ICC was contained.

11. One specific obligation – anti-money-laundering obligation for arbitration practitioners?

An interesting question is whether arbitrators and counsels in Swiss international arbitration are encumbered with anti-money-laundering duties. If the latter are deemed to make part of the international *ordre public,* then the answer is positive, as per Art. 190 (2) (e) PILA. In that case, another discussion arises: the anti-money-laundering obligations of which law? The *lex causae* will have the (*ratio materiae*) competence, for example, to declare the contract by which money laundering is tried on void, but it will not have the (*ratio personae*) competence to impose on persons working on an international arbitration, let us say, a duty to report the money laundering attempt. Rather, the *lex arbitri* must have such personal jurisdiction – it is the law that sets the rules for the international arbitration, hence, for the participants in the latter. However, only that part of the law of the seat which was created especially for international arbitration is applied to an international arbitration, thus, to an international arbitration's participants, without the rest of that law, i.e. solely Chapter 12 PILA, but not AMLA, applies to the persons working on a Swiss international arbitration. In other words, one ends up with «no law in their hands». 472

In any case, Art. 2 (3) AMLA applies only to the accepting or holding on deposit of assets belonging to others or the assisting in the investment or transfer of such assets and, with regard to activities outside the scope of Art. 2 (3) AMLA, Art. 9 (2) AMLA provides that their professional secrecy obligation under Art. 321 CrimC exempts legal professionals from a reporting duty. The participation in international arbitration by a legal professional is not an activity described in Art. 2 (3) AMLA, so it must not entail anti-money-laundering obligations[463]. Persons who have a role in an international arbitration but are not legal professionals – e.g. financial professionals, engineers and other experts appointed as arbitrators – must also be exempted, since this role is the same as the function of legal professionals. 473

[463] Most anti-money-laundering laws, not solely the Swiss ones, capture a limited circle of legal professionals' activities.

III. *Ex officio* obligation

474 In *Not Indicated v Not Indicated*, cons. 1, a) the Court stated that the existence of an obligation of an arbitrator to examine the validity of a contract in the light of the i.c. relevant EU competition law provision was certain («*en tout cas*») where the invalidity of the contract was invoked by one of the parties, thus leaving it open whether it was certain also in the absence of invocation.

1. *Pro*

1.1 Possibility to limit parties' freedom to choose applicable law

475 An *ex officio* duty to apply or consider overriding mandatory rules would be reconcilable with the freedom of the parties to choose applicable law. As concluded in Chapter 22, I., 1., this freedom may be limited in the name of the interests of others. Public interests which overriding mandatory rules protect are namely interests of others – the public is persons other than the parties to the international arbitration. Hence, the *ex officio* application or consideration of such rules would represent exactly such admissible limitation of parties' freedom to choose applicable law for the sake of the interests of others.

1.2 Iura novit curia

476 If it derives, *inter alia*, from the principle *iura novit curia*, an international arbitrator's duty to apply or consider overriding mandatory rules would be an *ex officio* duty. Under that principle it is the adjudicator, and not the party, who knows the law which needs to be applied or considered, so invocation by the party cannot be a precondition for applying or considering this law[464].

1.3 Interests of a state

477 SCHNYDER seems to favour an *ex officio* obligation of a judge to examine whether a foreign state has interests in the application of economic law. Because they belonged to a state, these interests could not be left to be decided

[464] KARRER, BSK IPRG, Art. 187 N 235.

on by the accident of a party's invoking them[465]. Since the overriding mandatory rules that would become relevant in international arbitration would also protect state interests, SCHNYDER's logic can also be applied to that type of procedure and justify an international adjudicator's *ex officio* obligation.

1.4 Precedence of potential arbitrator's ex officio duty to give effect to overriding mandatory rules over an agreement by the parties that he or she settles the dispute solely on the basis of the arguments they raise

In international arbitration, parties may agree that the arbitral tribunal resolves the dispute only on the basis of the arguments raised by them. This possibility is a type of freedom of contract and can be limited for the sake of interests of others, that is to say, of public interests. Since overriding mandatory rules namely protect general interests, a potential *ex officio* duty of the international arbitrator to apply or consider them should be able to limit such possibility. 478

2. *Contra*

2.1 Dominance of parties' will

The heaviest argument against an *ex officio* nature of an obligation of an international arbitrator to apply or consider overriding mandatory rules is that international arbitration is a procedure mostly (if not altogether) reigned by the parties' will. That was its idea – the reason why it was created. Expressions of this principle are, for example, the aforementioned possibilities for the parties to agree that the arbitrator resolves the dispute *ex aequo et bono* (to be discussed next) or that he or she takes into account solely the arguments raised by these parties. 479

2.2 Possibility to opt out of law altogether through authorisation for ex aequo et bono adjudication

Also here one can make the point of GIRSBERGER/VOSER/COLACINO/DONCHI and the authors cited by them (see above Chapter 21, II., 8.) that, through the 480

[465] SCHNYDER, Wirtschaftskollisionsrecht, 239.

possibility under Art. 187 (2) PILA to stipulate that the adjudication be *ex aequo et bono*, parties can exclude any law whatsoever (owing to Art. 190 (2) (e) PILA, only law with an international *ordre public* status would be preserved). This shows that, with regard to the *causa* for the substantive resolution, the parties have a lot in their hands, which can be an argument that an international arbitrator should not be allowed, and even less so be obliged, to apply or consider overriding mandatory rules unless some of these parties have requested that.

IV. Consequences of applying or considering overriding mandatory rules

481 The most proper criteria for the determination of the law governing the consequences of an international arbitrator's giving effect to overriding mandatory rules seem to be the type of consequences (direct or indirect) and the form of giving effect (application or consideration). The former reveals the intensity of the effect and the latter might imply discretion of the adjudicator with regard to such determination (when consideration). That the overriding mandatory rule envisages consequences shall not automatically mean that those apply – those of them which are direct shall, but those which are indirect shall not[466].

V. Conclusion

482 There is a general feeling that an international arbitrator has to apply or consider overriding mandatory rules. However, this is only a feeling. A high concentration of contradictory principles does not allow extraction of an unambiguous principle. Hence, *analogia iuris* cannot be employed for filling the legislative gap discussed here.

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[466] VOSER, Lois d'application immédiate, 272, 277, 278 (272: A. and first paragraph of B.; 277 continuing on 278: first paragraph of II.) treats in this way the envisaging of consequences by *lois d'application immédiate* in the context of litigation (she applies a foreseen direct but not a foreseen indirect consequence).

Chapter 23: New rules in Chapter 12 PILA

New legislation is always the best way to close a legislative gap, especially in civil law jurisdictions, like Switzerland, for which objective law is the central source of law. This is also the case with the gap in Chapter 12 PILA regarding overriding mandatory rules. New explicit rules dealing with the latter would ensure legal certainty – this would be highly beneficial, since the issue is such of great importance. Furthermore, by providing legal certainty on a matter which poses difficulties to international arbitrations all around the world, Chapter 12 PILA might «convince» more parties to arbitrate in Switzerland. In addition, the enactment of express rules would render PILA more consistent – if the latter's Chapter 1 regulates overriding mandatory rules and its Chapter 12 governs a procedure alternative to the procedure governed by Chapter 1, then coherence requires that Chapter 12 also addresses such rules. 483

In any case, the adoption of new rules is here not only the best but also the only solution because, as has been seen, *analogia legis* and *analogia iuris* are only partially helpful. 484

The adoption of new rules has so far not been discussed as a potential method for handling the legislative gap on overriding mandatory rules in international arbitration. The solutions put forward in the doctrine seek to manage the *status quo* rather than to change the current legislation. For instance, SCHNYDER builds a model of an autonomous (from private international law) special connection[467] without expressly saying that such a model should be incorporated into positive rules. 485

The rules proposed below, including the draft texts, do not claim to be ideal, and nor is it claimed that they should be adopted in their present form – there is room for their improvement, and suggestions in this direction are welcome. These rules rather serve as an example of how explicit legislation on the matter could look. 486

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467 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 317: «Development of an autonomous special connection model for arbitration?».

I. Modalities

1. When

487 New rules can be introduced with the revision of PILA currently under way.

2. Why explicitly

2.1 Addressing the problem at its root

488 The best way to handle a problem is to extirpate its cause. The latter here is the lack of explicit conflict of laws rules in Chapter 12 PILA. Therefore, the most reasonable solution would be to adopt such conflict of laws rules.

2.2 Worthiness equal to that of other issues which are regulated

489 The treatment of overriding mandatory rules in international arbitration is as significant as other matters which Chapter 12 PILA governs; if not even more significant, keeping in mind that public interests are concerned. Hence, it is justified to define the modalities of this treatment as well.

2.3 Another proposal for regulation of the treatment of overriding mandatory rules in international arbitration

490 A proposal for adoption of express rules in Chapter 12 PILA is not odd. DALHUISEN criticises the P.R.I.M.E. Finance Arbitration Rules' provision on applicable law (at that time Art. 35 (1)[468], currently Art. 36 (1)) for resting on a conflict of laws rule which, because of being used in «an environment of contractual (non-financial) disputes only» (meant is Art. 35 of the UNCITRAL Arbitration Rules), was inappropriate for international financial arbitrations (like those under the P.R.I.M.E. Finance Arbitration Rules) and apparently suggests explicit regulating in this provision (*inter alia*) of overriding mandatory rules[469]. This proposal has been partially embraced: considering of «the

[468] In the Rules' first edition from 16 January 2012.

[469] DALHUISEN, Applicable Law, 7.123, 7.124 (mainly 7.124). A more detailed analysis of the author on the applicable law and the international arbitrator's role in international financial arbitrations is available in DALHUISEN, Applicable Law and Arbitrators.

international and/or financial nature of the transaction and/or dispute», which corresponds to its first sentence[470], was added to the concerned P.R.I.M.E. Finance Arbitration Rules' provision.

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[470] The proposal (DALHUISEN, Applicable Law, 7.124) reads:

«The arbitral tribunal shall determine the applicable law, taking into account the internationality and financial nature of the transaction and/or dispute, the rules designated by the parties in areas of the law at their free disposition, the relevant property, regulatory and bankruptcy laws, as the case may be, as well as the requirements of the international or pertinent national public order especially in terms of, but not limited to, financial stability, risk management, protection of the commercial and financial flows, transactional and payment finality, competition, market abuse, other improper market practices, corruption and money laundering.

In doing so, the tribunal shall consider in particular the fundamental principles and public order requirements obtaining in international finance, the customs and practices that have developed in the international market place, relevant treaty law, and the general principles of law that may be found in the operation of advanced domestic financial markets.

The tribunal shall be authorised to raise issues of overriding fundamental principle or public order autonomously, subject to the rights of parties to equal treatment and a fair hearing.

If the parties have expressly authorised the arbitral tribunal to do so, the arbitral tribunal shall decide as amiable compositeur or ex aequo et bono in all matters at the free disposition of the parties.»

DALHUISEN's idea for the explicit authorising of the arbitral tribunal «to raise issues of overriding fundamental principle or public order autonomously, subject to the rights of parties to equal treatment and a fair hearing» can be accepted. First, it is well balanced, since it ensures that the conferred powers do not interfere with the procedural principles of equal treatment and a fair hearing. Second, it keeps the international arbitrator's «action» as wide as possible (he or she can «raise» the respective overriding matter), thus leaving him or her the opportunity to choose between applying and considering the overriding mandatory rule. Third, it contains an unambiguous order on the *ex officio* character of the international arbitrator's acting, which resolves the unclarity in that regard. On the other hand, the proposal takes too much of the parties' autonomy away – the latter is one of the core principles in international arbitration and, whilst international arbitration dealing with financial transactions is specific, it is not so specific as to justify complete deviation from one of this legal procedure's basic features. In particular, the draft provides for the taking into account (sic), instead of (the more intense) applying, of the rules designated by the parties and confers on such rules only the role of one, amongst many, equal factors to be considered by the inter-

3. Where

491 The suggested new rules would regulate treatment of overriding mandatory rules in international arbitration in particular, and that is why the *lex specialis* on the latter – Chapter 12 PILA – is the most appropriate «location» for them.

492 More precisely, the new rules could be embedded in the rule of Chapter 12 PILA which addresses applicable law: first, because their subject matter – overriding mandatory rules – would make part of the applicable law in the wide sense and, second, because this would bring about consistency in PILA, since also Chapter 1 PILA's rules on overriding mandatory rules (Art. 13, 18 and 19 PILA) are contained in the chapter's structural unit which deals with applicable law – Sec. 3. Chapter 12 PILA handles applicable law in Art. 187. The new conflict of laws rules could be incorporated in new paragraphs of the latter. Such proceeding would require the fewest changes to the structure of PILA – except that mentioned, no other provision would be modified.

493 In particular, a rule on overriding mandatory rules *legis causae* can be adopted as a new sentence added in Art. 187 (1) PILA, a rule on overriding mandatory rules of a third law can be adopted in a new Art. 187 (3), and a rule on the competition between overriding mandatory rules can be adopted in a new Art. 187 (4).

4. What kind of rules

494 The rules to be adopted will be conflict of laws rules, since here the conflict of laws approach to the problem is considered as most appropriate.

495 Then, the new rules will be autonomous rules. Reference rules that refer to the conflict of laws rules of Chapter 1 PILA, for example, would be a suboptimal solution, since the imperfections of the latter – such as the lack of clarity as to whether the second sentence of Art. 13 PILA only excludes the exclusion of overriding mandatory rules from the reference to the *lex causae* on the sole

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national arbitrator, i.e. a secondary role. The granting of *ex officio* powers of an international arbitrator with regard to the determination of overriding mandatory rules to be applied or considered should not lead to the taking away from the hands of the parties the decision about the applicable «ordinary» law.

basis of their public law character or whether it automatically includes them in such reference – would be «inherited». It is true that such reference rules could provide that the application be *mutatis mutandi*, but still the greatest legal certainty would be achieved through autonomous rules. With regard to the rule on competition between overriding mandatory rules, an autonomous rule is anyway the only possibility, for there is no rule to which a reference rule could made.

5. Prototypes

The new rules on overriding mandatory rules of the *lex causae* and of a third law could follow the terminology and the content of Art. 13 and 19 PILA as long as the latter are appropriate for the particularities of international arbitration and constitute good solutions. That would ensure, at the same time, harmony with Chapter 1 PILA and preservation of the spirit of Chapter 12 PILA. The new rule on competition between overriding mandatory rules could be based, *inter alia,* on SCHNYDER's rule of reason. 496

6. Terminology

There is difference in the language versions of Art. 187 (1) PILA as to the systems of rules possible to be chosen by the parties as applicable – the current German and Italian texts refer to «law» («Recht» bzw. «diritto»), while the French one refers to «rules of law» («règles de droit»). It would be better to synchronise the different translations of Art. 187 (1) PILA and, as a matter of fact, the proposal for amendments to PILA's Chapter 12 which was in consultation from 11 January 2017 until 31 May 2017 includes a step in this direction; in particular, it embeds the term «rules of law», currently used in the French text, into the German and Italian version of Art. 187 (1) PILA. This suggestion is supported here, as it is in harmony with the international trend towards expanding the circle of norms able to obtain effect in international arbitration – in particular the trend towards granting this ability to other norms apart from those of national legal orders. Due to the presence of this proposal for changes in Art. 187 (1) PILA, each draft proposed here is elaborated in two versions – one which, like the current Art. 187 (1) PILA, uses the word «law» and one which refers to «rules of law», as if the suggested amendment was adopted. However, for the sake of simplicity, the reasoning behind the drafts 497

is explained only in the language of the current Art. 187 (1) PILA (with a reference to «law»).

498 The draft provisions refer to the law designated «in the first paragraph» of Art. 187 PILA without mentioning the law designated by the second paragraph, as the latter does not designate a law but non-legal concepts (*ex aequo et bono*).

7. Sanctions

499 Compliance with the new conflict of laws rules would not be sanctioned. An arbitral award through which they are violated will not be annullable under Art. 190 (2) PILA, as the latter will continue to guard only *ordre public.*

II. Content

1. Rule on overriding mandatory rules *legis causae*

500 Overriding mandatory rules of the *lex causae* represent a more acute issue in international arbitration than in (private international law) state court proceedings. However, like in the latter, they are less problematic than overriding mandatory rules of a third law. The most likely reason is the availability of a solution –uniform connecting – which, though not conceptually ideal, is practical, and indeed the majority of authors consider, for example, the overriding mandatory rules of the most often type of *lex causae* – the chosen law – as included in the latter[471].

1.1 Draft

a If in Art. 187 (1) PILA the word «law» is not substituted with the expression «rules of law»

501 If in it the word «law» is not substituted with the expression «rules of law», for instance, the following sentence could be added to Art. 187 (1) PILA:

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[471] See also GIRSBERGER/VOSER/COLACINO/DONCHI, 1394 (*in initio*).

«The reference of this paragraph to a law encompasses all rules which, according to that law, apply to the facts of the case, including rules of a public law character.»[472].

In that case, Art. 187 (1) PILA would read as follows (with the text not formatted in italics representing the current Art. 187 (1) PILA): 502

«The arbitral tribunal decides the disputed matter according to the law chosen by the parties or, in the absence of a choice of law, according to the law with which the disputed matter is most closely connected. *The reference of this paragraph to a law encompasses all rules which, according to that law, apply to the facts of the case, including rules of a public law character.»*.

b If in Art. 187 (1) PILA the word «law» is substituted with the expression «rules of law»

If Art. 187 is amended to refer to «rules of law» instead of «law», the sentence to be added could be reformulated like this: 503

«The reference of this paragraph to rules of law encompasses all rules of law which belong to the respective legal system and which, according to the latter, apply to the facts of the case, including rules of law which have a public law character.»[473].

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472 – in German perhaps: «*Die Verweisung dieses Absatzes auf ein Recht umfasst alle Bestimmungen, die nach diesem Recht auf den Sachverhalt anwendbar sind, einschliesslich Bestimmungen, denen ein öffentlich-rechtlicher Charakter zugeschrieben wird.*». (The adjective «öffentlich-rechtlich» is spelled hyphenated, even if it is not spelled this way in the legislative provision used as a model of the here proposed draft – Art. 13 PILA – and in some other official Swiss legal acts, for that is the correct spelling according to Rechtschreibung, Leitfaden zur deutschen Rechtschreibung, Schweizerische Bundeskanzlei, in Absprache mit der Präsidentin der Staatsschreiberkonferenz, 4., aktualisierte Auflage 2017, Bundeskanzlei BK.).

473 – in German something like: «*Die Verweisung dieses Absatzes auf Rechtsnormen umfasst alle Rechtsnormen, die zu dem jeweiligen Rechtssystem gehören und nach dem letzteren auf den Sachverhalt anwendbar sind, einschliesslich Rechtsnormen, denen ein öffentlich-rechtlicher Charakter zugeschrieben wird.*». (With regard to the spelling of the adjective «öffentlich-rechtlich», please see fn. 472.)

Art. 187 (1) PILA would then read (the first sentence being one already proposed within the current revision of PILA's Chapter 12):

«The arbitral tribunal decides the disputed matter according to the rules of law chosen by the parties or, in the absence of a choice of law, according to the rules of law with which the disputed matter is most closely connected. The reference of this paragraph to rules of law encompasses all rules of law which belong to the respective legal system and which, according to the latter, apply to the facts of the case, including rules of law which have a public law character.».

1.2 Uniform connection

505 The proposed rule implements the uniform connection, i.e. it includes the overriding mandatory rules of the *lex causae* into the conflict of laws reference to the latter. This connection is preferred here, first, because, as concluded in Part 3 (see e.g. Chapter 13, III.), it is more practical. Second, there are some signs of it having been applied to international arbitration. When in *Terra armata*, cons. 2.2.2., fourth paragraph, *in fine* they give foreign *lex causae* and third law as examples of the law failure in connection to which is not sanctioned by Art. 190 (2) (e) PILA, the judges narrow down the example of third law to the overriding mandatory rules of such a third law («immediately applicable mandatory provision of a third state»), whilst they do not do this with the example of foreign *lex causae*. *Per argumentum a contrario* the governing law meant encompasses all rules of such governing law, including its overriding mandatory rules, and this is an indication that the Court considers the latter as applicable by virtue of their belongingness to the governing law. The Hague Principles on Choice of Law also seem to connect uniformly the overriding mandatory rules of the type of *lex causae* with which they deal – the chosen law – when it comes to an arbitration procedure. In their Art. 11 (5), they provide that they do not prejudice the effect of overriding mandatory rules of a third law and do not mention anything on the effect of the overriding mandatory rules of the chosen law, which cannot be explained except with an existing perception that the overriding mandatory rules of the chosen law are not at risk of being prejudiced – most probably because they are already encompassed in the choice of law.

1.3 Art. 13 PILA as a prototype

a Corresponding to Art. 13 PILA

If installing the uniform connection for the overriding mandatory rules of the *lex causae*, the new rule would overtake the content of Art. 13 PILA as understood by the majority of authors. The content of that article's first sentence would be followed entirely. From the second sentence, the term «public law character» would be used. 506

b Deviating from Art. 13 PILA

aa. Structure

The new rule would consist of one sentence, not of two like the rule in Art. 13 PILA, and would make part of an article that would contain also other rules – Art. 187 PILA – rather than be contained in an autonomous provision. 507

bb. Inclusion, not only exclusion of automatic exclusion

The text would be much firmer than Art. 13 PILA on the action of including the *lex causae*'s rules of a public law character, and with this the *lex causae*'s overriding mandatory rules, into the conflict of laws reference to such *lex causae*, i.e. on the construing of a uniform connection. To that end, the elements of Art. 13 PILA's text which cause uncertainty as to whether also such inclusion of the *lex causae*'s norms of a public law character or only the exclusion of their automatic exclusion is meant – Art. 13 PILA's second sentence and the verb «exclude» – would be left away. 508

cc. Overriding mandatory rules of the proper law, not overriding mandatory rules of the proper foreign law

The new rule would deal with the rules of a public law nature of the «proper law», not (like Art. 13 PILA) only of the «proper foreign law». The latter provision needed to shape the destiny only of the norms of a public law character of a foreign *lex causae*, not also those of a non-foreign, i.e. Swiss, *lex causae*, for a Swiss state court to which it is addressed will at any rate follow the latter – except of the proper law, they will make part of the *lex fori* (Swiss law is the 509

lex fori of a Swiss state court) and the *lex fori*'s rules of public law nature are obligatory for a Swiss state court. Because, by contrast, a Swiss international arbitration court will not apply Swiss rules of a public law character by virtue of their capacity as rules of public law nature of the *lex fori* (a Swiss international arbitration court is not bound by such rules), one needs to provide in an objective norm for the inclusion of such rules into the reference to a Swiss *lex causae*, if wishing to see them being applied by a Swiss international arbitrator who enforces such Swiss *lex causae*.

dd. Definition of the scope of the reference to a law of Art. 187 (1) PILA, not of the scope of the reference to a law of PILA

510 The new rule would define the scope of Art. 187 (1)'s reference to a law, not the scope of PILA's reference to a law, like Art. 13 does. Yet, this «deviation» is actually no deviation – it is there by definition, since the rule proposed determines the scope of the reference to a law that applies in international arbitration, and this reference is made namely solely in Art. 187 (1) PILA.

1.4 No need for a rule on the law governing the consequences of applying overriding mandatory rules legis causae

511 There is no need to add any conflict of laws rule defining the law to govern the consequences, both direct and indirect, of the application of the overriding mandatory rules of the *lex causae*, since such law can only be this very same *lex causae* – solely it (and no other *lex*) seeks and is able to perform this role. Besides, when (as here) the *lex causae* is uniformly connected to, it is most logical that the consequences of the application of its overriding mandatory rules are defined by it. If such rules are reckoned a part of it, they should be treated in the same way as its other rules, i.e. its ordinary rules. Since the latter are applied together with the consequences this law envisages for them, also its overriding mandatory rules should be applied together with the consequences which it attaches to such overriding mandatory rules. Further, the fact that the overriding mandatory rules of the *lex causae* are applied legitimises the attaching to them of the consequences foreseen by this law, for application (unlike consideration) represents giving of full effect to rules. In addition, since the direct consequences of the application of overriding mandatory rules are tightly connected to such overriding mandatory rules, it is most natural that

the law containing such overriding mandatory rules governs them and the indirect consequences are suitable for being regulated by the *lex causae* because they anyway pose a question for which that *lex* is responsible – the balance between the parties' individual interests. The EU legislature, for example, appears to apply the *lex causae* to the direct consequences of the application of an overriding mandatory rule *legis causae* which renders a contract null: Art. 12 (1) (e) of Rome I «Scope of the law applicable» provides that «The law applicable to a contract by virtue of this Regulation shall govern in particular: …(e) the consequences of nullity of the contract.» and nullity of a contract might follow, amongst others, from application of an overriding mandatory rule of the *lex causae*.

2. Rule on overriding mandatory rules of a third law

For international arbitration courts, «third law» would mean a law that is different than the *lex causae*, and not, as for state courts, a law that is neither the *lex causae* nor the *lex fori*. That is so because the *lex fori* has no special status in international arbitration. 512

As became clear, the effect of overriding mandatory rules of a third law poses bigger problems than that of overriding mandatory rules *legis causae*, and this is so also in international arbitration. 513

In the past, worldwide (not only in Switzerland) international arbitrators had been seen as not obliged to apply the overriding mandatory rules of a third law. First, the applicability of such rules had been something rare already for state courts and, second, where (as often happened in this type of dispute resolution) the *lex causae* had resulted from parties' choice, these adjudicators had been too much bound by such choice due to the principle in this procedure of dominance of the parties' will. In 1985, however, a decision of the US Supreme Court – *Mitsubishi Motors Co. v Soler Chrysler-Plymouth, 473 US 614 (1985)* – opened a new reality. It allowed application by an arbitral tribunal of a US antitrust mandatory law, even though Swiss law governed the set of facts. 514

Nowadays, some authors support the application by international arbitrators of mandatory rules of a third law when these rules are strongly connected to the case and their objective is worthy of being protected. Others suggest that, 515

in view of the need to ensure the effectiveness of the award, international arbitrators should apply only the mandatory rules of the law at the place of the contract's performance or of the award's enforcement.[474]

516 It is here sustained that an international arbitrator would need an even stronger case than a state judge in order to consider a third law's overriding mandatory rules because he or she is tightly bound to the *lex causae* when the latter is chosen by the parties – which is frequently the case in international arbitration. This bindingness is owed to the principle of dominance of the parties' will reigning in this type of legal procedure, which reinforces the idea of international arbitrator as a forum tailor-made to the parties and ensuring legal certainty (it is known from the beginning what law will apply to the contract).

2.1 Draft

a If in Art. 187 (1) PILA the word «law» is not substituted with the expression «rules of law»

517 The following new (third) paragraph could be added to the current Art. 187 PILA:

«Instead of the law which is designated by paragraph 1, the rule of another law, which rule wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other law. Whether such a rule is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule are to be governed by

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[474] GIRSBERGER/VOSER/COLACINO/DONCHI, 1375 (where «lois d'application immédiate» seems to refer to «overriding mandatory rules», i.e. to overriding mandatory rules in general, not, as here, only to overriding mandatory rules of the *lex fori*).

this other law and the indirect consequences – by the law designated by paragraph 1.»[475].

b If in Art. 187 (1) PILA the word «law» is substituted with the expression «rules of law»

If «law» in Art. 187 (1) PILA is substituted with «rules of law», the new, third paragraph proposed here to be added to Art. 187 could be formulated: 518

«Instead of the legal system which is designated by paragraph 1, the rule of law of another legal system, which rule of law wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other legal system. Whether such a rule of law is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule of law are to be governed by this other legal system and the indirect consequences – by the legal system designated by paragraph 1.»[476].

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[475] – in German maybe: «*Anstelle des Rechts, das durch Absatz 1 bezeichnet wird, kann die Bestimmung eines andern Rechts, die zwingend angewandt sein will, berücksichtigt werden, wenn nach universeller Rechtsauffassung schützenswerte und offensichtlich überwiegende Interessen einer Partei es gebieten und der Sachverhalt mit jenem Recht einen engen Zusammenhang aufweist. Ob eine solche Bestimmung zu berücksichtigen ist, beurteilt sich nach ihrem Zweck und den daraus sich ergebenden Folgen für eine nach universeller Rechtsauffassung sachgerechte Entscheidung. Auf die unmittelbaren Rechtsfolgen der Berücksichtigung einer solchen Bestimmung ist dieses andere Recht und auf die mittelbaren Rechtsfolgen das durch Absatz 1 bezeichnete Recht anzuwenden.*».

[476] – in German something like: «*Anstelle des Rechtssystems, das durch Absatz 1 bezeichnet wird, kann die Rechtsnorm eines andern Rechtssystems, die zwingend angewandt sein will, berücksichtigt werden, wenn nach universeller Rechtsauffassung schützenswerte und offensichtlich überwiegende Interessen einer Partei es gebieten und der Sachverhalt mit jenem Rechtssystem einen engen Zusammenhang aufweist. Ob eine solche Rechtsnorm zu berücksichtigen ist, beurteilt sich nach ihrem Zweck und den daraus sich ergebenden Folgen für eine nach universeller Rechtsauffassung sachgerechte Entscheidung. Auf die unmittelbaren Rechtsfolgen der Berücksichtigung einer solchen Rechtsnorm ist dieses*

2.2 Special connection

519 The overriding mandatory rules of a third law can be given effect only through the special connection. Hence, here the latter is used.

2.3 Overriding mandatory rules of the different types of third laws

a Overriding mandatory rules *legis fori*

520 Whether the overriding mandatory rules *legis fori* are at the same time overriding mandatory rules of the *lex causae* – because *lex fori* is also *lex causae* – is here not taken into account. Only the consequence of the origination of an overriding mandatory rule from the *lex fori* is examined (the significance of the belongingness of such a rule to the *lex causae* is analysed at another place – when dealing with overriding mandatory rules *legis causae*).

aa. Lack of preferential treatment

521 Overriding mandatory rules of the *lex fori* – here of Swiss law – cannot have the same role for international arbitration as for state courts; international arbitration is not bound to protect the legal order of the seat as the latter are. When doing so, an international arbitrator would consider the overriding mandatory rules of the *lex fori* not as a measure of protection of the latter but as part of his or her task to resolve the dispute – this task would simply include, amongst others, the finding of the relevant law[477]. For such an adjudicator, the overriding mandatory rules of his or her *lex fori* are as much overriding mandatory as the overriding mandatory rules of any other law which is not *lex causae*, i.e. of any third law. He or she would treat a conflict between the overriding mandatory rules of the *lex fori* and the overriding mandatory rules of another law which is not the *lex causae* as if it were a conflict between the overriding mandatory rules of any two laws which are not the *lex causae*, i.e.

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andere Rechtssystem und auf die mittelbaren das durch Absatz 1 bezeichnete Rechtssystem anzuwenden.».

477 CHRISTEN, 22.

of any two third laws[478]. That is different than the situation in state court proceedings, where Art. 18 PILA would cause the overriding mandatory rules of the *lex fori* to override the overriding mandatory rules of another law which is not the *lex causae*, even to override the overriding mandatory rules of the *lex causae*. International arbitration simply lacks substantive law, conceptual and often factual nexus to the seat. The absence of a substantive law connection is visible, amongst others, from interpretation *per argumentum a fortiori* of Art. 190 (2) (e) PILA. This article confers no special protection to the Swiss *ordre public* (it does not speak of «Swiss ordre public» as Art. 17 PILA but of «ordre public»). If even the Swiss *ordre public* does not enjoy special protection, the Swiss overriding mandatory rules must also not, since its *ordre public* is even more paramount to Switzerland than its overriding mandatory rules (an *a fortiori* argument). An international arbitration will be close to the law of the seat only with regard to procedural and conflict of laws issues[479]. As to the insufficient conceptual nexus of the international arbitration to the seat, the idea of international arbitration is to be a forum that is as distant as possible from state legal orders, including from the state legal order of the seat. Last but not least, often the case will not reveal even a factual relation to the seat, as the latter will have been appointed as such due to its neutrality.

A position that international arbitration is distant from the *lex fori* is taken also in the literature. For instance, SCHNYDER, when discussing market regulatory law, underlines that the seat gives a procedural and conflict of laws frame to the arbitration, without bringing with itself necessity for the observance of the market regulatory law of the *lex fori*[480]. In order to apply in international arbitration, the overriding mandatory rules of the *lex fori* would have to prove separately, as the overriding mandatory rules of any other third law would have to, that they are overriding mandatory and connected to the case. KARRER, similarly, points out that the Swiss *ordre public* rules (which he understands as equal to overriding mandatory rules) could be applied or considered 522

[478] Also SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 321; KARRER, BSK IPRG, Art. 187 N 258.

[479] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 316.

[480] SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 316, 317.

by a Swiss arbitrator not by virtue of them belonging to the *lex fori arbitri*, in particular not by virtue of Art. 18 PILA, but only through applying by analogy to international arbitration the rule that deals with overriding mandatory rules of a third law – Art. 19 PILA[481].

bb. Some consequences of the lack of preferential treatment

523 The consequences of the lack of preferential treatment of overriding mandatory rules *legis fori* in international arbitration are the following.

No control for compliance with lex fori

524 For an international arbitrator, the overriding mandatory law of the forum will not constitute any barrier to the application or consideration of the overriding mandatory law of another state – such application or consideration will be proceeded to also where this overriding mandatory law of another state contradicts with the overriding mandatory law of the forum. In comparison, a state court would have to prefer the overriding mandatory rules of the *lex fori*[482].

No substitution with lex fori in case of contravention of the lex causae with ordre public

525 Due to the lack of connection of the international arbitration to the substantive *lex fori arbitri*, one can agree with KARRER that in case of contradiction of the result following from the application of Art. 187 PILA with the negative *ordre public*, a Swiss international arbitral tribunal does not have to apply Swiss law (but the law with the closest connection to the case) as a substitution[483].

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481 KARRER, BSK IPRG, Art. 187 N 258.

482 KARRER, BSK IPRG, Art. 187 N 258, last sentence. See also CHRISTEN, 22.

483 KARRER, BSK IPRG, Art. 187 N 229. However, KARRER's position that this solution is contrary to that in cipher 214.52 of the dispatch on the PILA (in German: *Botschaft IPRG*) is here not agreed with. The latter dealt with the application of *ordre public* in state court proceedings, and not in arbitration. Neither were arbitration courts explicitly mentioned, and nor does the article discussed – Art. 16 at that time, nowadays Art. 17 PILA – on the reservation of Swiss *ordre public* apply directly in international arbitration. It can also be noted that it is not clear which *lex causae* KARRER speaks of – that which was chosen by

Not «lois d'application immédiate»

That they do not prevail over the overriding mandatory rules of other laws, like the overriding mandatory rules of the *lex fori imperi* do, means that the overriding mandatory rules of the *lex fori arbitri* cannot be called «*lois d'application immédiate*», as the latter are. 526

Not a separate category of overriding mandatory rules

Since an international arbitrator will view them as equal to the overriding mandatory rules of any other third law, and not, like a state judge, as an alternative (together with the overriding mandatory rules *legis causae*) of the overriding mandatory rules of such other third law, the overriding mandatory rules *legis fori* in international arbitration will make part of the overriding mandatory rules of a third law, and will not represent a separate category. That is why they are considered here under the heading «overriding mandatory rules of a third law», and not under a separate structural unit equally footed to «overriding mandatory rules of a third law» as in the literature on state courts. In fact, the practice and doctrine on international arbitration often confer special space to overriding mandatory rules *legis fori*, but that is in order to explain that they do not represent a separate category. 527

If, for an international arbitrator, overriding mandatory rules of the *lex fori arbitri* are not a separate class, then only two categories remain to be relevant for him or her: overriding mandatory rules of the *lex causae* and overriding mandatory rules of a law other than the *lex causae* (overriding mandatory rules 528

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the parties (Art. 187 (1) PILA, first suggestion) or that which was objectively connected to (Art. 187 (1) PILA, second suggestion) or both. It can be supposed that he considers the *lex causae* which results from a choice of law because what he suggests for the case of contradiction between such *lex causae* and the negative *ordre public* is that the arbitrator applies the law most closely connected to the case, which, in fact, is the action envisaged by the second suggestion of Art. 187 (1) PILA, and the law that one proposes as a substitution must be different than the law that is to be substituted. If this is so, i.e. if KARRER really meant only the *lex causae* which has been chosen by the parties, the question remains as to which law should substitute the *lex causae* defined through the objective connection where that is contrary to the negative *ordre public.*

of a third law)[484]. At first sight, it seems inappropriate to call the overriding mandatory rules of a law that is not the *lex causae* «overriding mandatory rules of a *third* law»; there are two, not three, relevant categories, so in literal terms it would be a «second» law (hence «overriding mandatory rules of a *second* law»). However, in technical legal language, «third» can mean «another, different, any other» instead of «one that follows two others»[485] [486].

b Overriding mandatory rules of the place of the contract's performance

529 The fact that overriding mandatory rules make part of the law which is in force at the place of the contract's performance can indirectly facilitate the effect within international arbitration of such overriding mandatory rules because it constitutes or at least brings about the connection required by the new rule for the giving of effect to such rules – namely the connection between these overriding mandatory rules and the case. However, the other criteria for the giving of the effect will need to be proven separately, including the criterion that the here mentioned (established) connection is close.

530 In England, the overriding mandatory rules that belong to the law of the place of performance enjoy a special status – thanks to the Ralli rule, under which an infringement of the rules, except for revenue and fiscal rules, of such law lead to unenforceability of the contract.

c Overriding mandatory rules of the law of the place of the arbitral award's enforcement

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[484] Also KAUFMANN-KOHLER/RIGOZZI, 7.94 (equally prompted by the loose, *simpliciter* procedural, nexus of the international arbitration to the seat) see dualism in the perception of an international arbitrator – the latter had «only two possible sources of mandatory rules: the lex causae and third legal systems (which includes the lex fori)».

[485] For instance, when, within the context of property law, it is said that a «third party» may not prevent the owner from exercising certain rights with regard to the property, any other (than the owner) party, and not a party which is third next to the owner and some other party, is meant.

[486] Also KAUFMANN-KOHLER/RIGOZZI, 7.94 use the word «third» when talking about two categories of overriding mandatory rules.

The place of the arbitral award's enforcement is a concept different than the place of the seat of the international arbitration. Enforcement can, but must not, be sought in the seat. In the seat the award is directly enforceable and the question of enforcement is hardly posed.

Formally, an international arbitrator does not have to consider the overriding mandatory rules of the place of the award's enforcement. Firstly, the legal effect of the award does not depend on its enforcement because the parties can implement it voluntarily. Second, the law of enforcement is not necessarily connected to the merits of the case, as when deciding in which country to enforce the award, the (winning) party looks at where the losing party's assets are located without searching for the country whose law relates the most to the case's substance (anyway already ruled upon). Third, compliance with the overriding mandatory rules of the state in which enforcement is asked rarely constitutes a ground for refusal of enforcement – rather the *ordre public* does (Art. V (2) (b) New York Convention). Fourth, even if they want to consider the overriding mandatory rules of the place of enforcement, international arbitrators are often not able to do so, since at the time of adjudicating they do not know which those overriding mandatory rules are, as the place of enforcement is not yet known. In the world of today's globalised business, especially financial business, the assets of debtors are frequently situated in various countries around the globe, and the creditors' choices of state in which to enforce are not easily predictable. Even if an international arbitrator manages to read some intention in the creditor's actions during the procedure, there is no guarantee that this intention will not change after the procedure finishes. 532

d Overriding mandatory rules of the law of a party's incorporation

The belonging of overriding mandatory rules to the law under which a party to the dispute is organised cannot in itself ensure the consideration of those rules. Similarly to the belonging of overriding mandatory rules to the law of the place of the contract's performance, it can only fulfil or contribute to the fulfilling of one of the several requirements for such consideration – namely the connection between the overriding mandatory rules and the case. In *ICC Case No. 1512* (YCA, Vol. V, 1980, 170ff.), the arbitral panel refused to consider a Pakistani law declaring payments to Indian parties illegal which was relied on by a Pakistani bank that had refused to pay under a guarantee it had 533

issued to an Indian party under Indian law. Most probably the international arbitrators saw this law under which one of the parties was organised as an overriding mandatory law but also as a subjective political demonstration of hostility which they could not support – the law was enacted within a series of acts adopted by India and Pakistan after deterioration in their relations – i.e. in this case the quality of the overriding mandatory law (if one accepted that this law was overriding mandatory law) as a law of one of the parties was not enough to trigger its consideration.

e Overriding mandatory rules of the law that would have been applicable if there was no choice of law

534 Considering the overriding mandatory rules of the law that would have applied (had no choice of law been made) could be important for counteracting parties' attempts to evade such rules. Such overriding mandatory rules would fulfil the criterion of being connected to the case because the conflict of laws rule that determines the law applicable in the absence of a choice law would not have determined the law to which they belong as applicable, if the latter was not related to the case. However, a question remains whether such a connection will be the closest connection.

f Connected in other way

535 The enumeration of types of third laws whose overriding mandatory rules may be considered is exemplaric. The overriding mandatory rules of laws connected to the case in any other way can be considered too.

g Conclusion

536 For Swiss international arbitration courts, the exact origin of the third overriding mandatory rules is not decisive. It is relevant only insofar as it reveals a certain connection (of such rules) to the merits of the case, but it does not ensure the meeting of the rest of the criteria for consideration of such rules. So far, the situation for international arbitration courts is the same as that for state courts. The difference is that international arbitration courts do not, like state courts, confer special status to the overriding mandatory rules of the *lex fori* but treat them as overriding mandatory rules of a third law.

2.4 Art. 19 PILA as a prototype

a Corresponding to Art. 19 PILA

The language and content of Art. 19 PILA are followed (which is overtaken generally but not completely). The controversial requirement of the German and Italian translation that the interests touched upon be those «of a party» is preserved. Kept is also the act of consideration (as opposed to application). The presence of this lighter form of giving effect to the third law's overriding mandatory rules is even more important for an international arbitrator than for a state judge because the international arbitrator can barely afford themselves to deviate from the *lex causae*. 537

b Deviating from Art. 19 PILA

aa. Structure

The proposed rule differs from the rule in Art. 19 PILA in that it is structured in one paragraph, instead of two paragraphs. In this way, the rule is kept compact and the treatment of overriding mandatory rules of a third law is more clearly separated from the treatment of other issues in Art. 187 PILA. 538

bb. Overriding mandatory rules of a third law, not overriding mandatory rules of a third foreign law

The term «foreign» from Art. 19 PILA's title is not mentioned in order that the new rule covers not only the overriding mandatory rules of a foreign third law but the overriding mandatory rules of any third law, i.e. also the overriding mandatory rules of the domestic law which is the *lex fori*. The goal is to ensure that the latter are treated equally with the overriding mandatory rules of a foreign third law, as this is appropriate in an international arbitration procedure. 539

cc. Universal instead of Swiss perception of law

It seems unacceptable that in international arbitration the conditions for the consideration of a third law's overriding mandatory rules – the legitimacy and manifest preponderance of a party's interests in such consideration and the appropriateness of the decision to be rendered – be appreciated according to 540

the «Swiss perception of law» (Art. 19 PILA)[487]. International arbitration is too distant, in a substantive aspect, from the national legal order of the (here Swiss) seat[488] to evaluate such substantive criteria through the perception of law of that legal order.

541 The question is what the substitution for the Swiss perception of law in the new rule should be and should there be substitution at all. Natural substitutions seem to be the perceptions of law of the other involved laws apart from the Swiss *lex fori* – the third law the consideration of whose overriding mandatory rules is being contemplated and the *lex causae*. However, the perceptions of law of these laws are unfit. The third law is arguably biased: since (through the overriding mandatory rules whose consideration is being thought of) it protects them, it will always deem the concerned interests legitimate and manifestly preponderant and the decision appropriate. Having the governing law as a starting point is suboptimal because this law might see the interests as legitimate and manifestly preponderant and the decision as appropriate too rarely because the interests are protected by a law other than it – a third law. Besides, relying on the *lex causae*'s perception of law might too much resemble the material law approach which is, in fact, not undertaken here. The most suitable solution is to use some universal perception of law. The latter will correspond to the universal mindset of international arbitration. Such universal perception of law might sometimes be influenced by the perception of law of the jurisdiction in which the international arbitrator was educated, since it is natural for them to look from the perspective of the law which they were trained in, but that will not be so detrimental – and anyway, this probability will have been, or at least will have had to have been, predicted by the parties (who nominated the international arbitrators). The last option would be to allow the international arbitrator to choose completely on their own the premise from which to make the evaluation. That can be achieved through omitting to specify in the

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487 KAUFMANN-KOHLER/RIGOZZI, 7.98 and the authors referred to by them also consider that within application of Art. 19 PILA to international arbitration there should be adaptation of that article's Swiss law perspective.

488 The already-cited SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 315, 316; MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 28; CHRISTEN, 20 and the references in fn. 109 thereof.

new rule the perception of which law is to be used. However, that solution would most probably produce the same result as the solution of providing for a universal perception of law because after, for the reasons stated above, the international arbitrator does not find help in the *lex causae* or the third law, he or she would most likely turn to this universal perception of law.

2.5 Rule on the law governing the consequences of considering overriding mandatory rules of a third law

Unlike the determination of the law applicable to the consequences of the giving effect to the overriding mandatory rules *legis causae*, determination of the law applicable to the consequences of the giving effect to the overriding mandatory rules of a third law is difficult since more than one law, in particular the third law and the *lex causae*, might show willingness to regulate – there is a conflict of laws. For instance, where an insurance contract is submitted to Swiss law and Spanish law's requirements for the registration of the insurance company are considered in their capacity of a third overriding mandatory law, the question is raised whether Spanish law which envisages voidance of the contract or Swiss law which does not foresee such voidance (but only an administrative sanction) should be applied to the consequences of such consideration[489]. 542

a Law governing the direct consequences

There are the following positions which one may take in this respect. 543

aa. No need of a rule because of adjudicator's discretion within «consideration»

For some, the fact that Art. 19 PILA provides for the overriding mandatory rule to be «considered» means that the judge can decide what consequences to draw from such an overriding mandatory rule (e.g. partial nullity of the contract, suspension of the performance, etc.), and such discretion includes the determination of law that governs them (one must have drawn them from some 544

[489] See SCHNYDER, Wirtschaftskollisionsrecht, 279, fn. 24 giving an example with Art. 6 (1) of the Spanish Insurance Supervision Act from 2. August 1984.

law[490]). Indeed, the term «consideration» features a nuance of discretion. The providing in Art. 19 (2) PILA that the consequences of the consideration for the just resolution of the dispute be evaluated does not hinder such interpretation, since this evaluating implies that the consequences have already been identified (one cannot appreciate something one is not familiar with), which presupposes that the consequences have been extracted from some law, and this on its part means that such a law has already been determined (by the evaluator, i.e. adjudicator). If this logic is followed, the new rule would not need to determine expressly the law that governs the direct consequences of the consideration it prescribes.

bb. Law to be defined by the international arbitrator

545 One can also expressly delegate the determination of the law to govern the direct consequences of the consideration to the international arbitrator through embedding in the new rule a sentence such as «The arbitrator applies to the direct consequences of such consideration the law which they view as appropriate.».

cc. Law of the overriding mandatory rules

546 Being direct, the consequences in question are so closely connected to the considered overriding mandatory rule that not applying to them the law of the latter would be equal to leaving its consideration unfinished. Separating a rule from the direct consequences of its consideration by submitting those to a law different than the law to which it is submitted would be somehow unnatural. Other authors also make a similar point, admittedly with regard to the direct consequences of an overriding mandatory rule of the *lex fori*, but their reasoning can be relied on since it is also about closeness between the overriding mandatory rule and its direct consequences. MOSCHER (agreed with by VOSER) states that the overriding mandatory rules of the *lex fori* can be catered

490 MÄCHLER-ERNE/WOLF-METTIER, Art. 19 N 32, 33. Also VOSER, Lois d'application immédiate, 272, first paragraph underlines that the act of consideration referred to in Art. 19 PILA implies the adjudicator's discretion with regard to the legal consequences.

for only when the *lex fori*'s «ideas about law» come to a breakthrough also in the legal effect of the overriding mandatory rules on the private law relationship[491]. For VOSER, prohibitions with criminal sanctions show particularly clearly «the close connection between the overriding order and the legal consequence» since it would be contrary to the unity of the legal order if the contract's conclusion or content is subjected to the Swiss *lex fori*'s public criminal law sanctions while its civil law consequences – to the *lex causae*[492]. Also, SCHNYDER believes that the direct consequences of the application of an overriding mandatory rule of the *lex fori* for the private law relation should be taken from that rule, in particular from its wording or through its interpretation[493].

Second, the *lex causae* might not at all regulate the consequences of the consideration of the third law's overriding mandatory rule. If, for example, it does not contain a rule dealing with a topic similar to that which the third overriding mandatory rule addresses, it might not need, and thus not contain, such regulation. 547

Last but not least, applying to the direct consequences of the consideration of an overriding mandatory rule a law different than the law having issued such an overriding mandatory rule might lead to contradictions, since the consequences envisaged by this other law might be incompatible with the logic of the law author of the overriding mandatory rule. 548

dd. *Lex causae*

Lex causae is the law that reigns over the relationship between the parties, and that law is fit for regulating effects on this relationship, such as direct consequences of the consideration of overriding mandatory rules. It is true that, due to being direct, these consequences are closely related to the overriding mandatory rules and thus to the public law interest protected by these, but they will still occur within the private law relation between the parties. 549

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491 MORSCHER, 93, fn. 43 and VOSER, Lois d'application immédiate, 273 (own translation from German).

492 VOSER, Lois d'application immédiate, 273 (*in fine*), 274 (*in initio*).

493 SCHNYDER, Wirtschaftskollisionsrecht, 279.

Second, it might be more suitable for the nature of the consideration of the third overriding mandatory rules as an exception to the application of the *lex causae* if the *lex causae* governs the direct consequences of such consideration. Exceptions are to be interpreted and applied restrictively – only within the necessary minimum – so that the giving of effect to the third law here should remain within what is necessary[494], which is the considering of this third law's overriding mandatory rules, but not also the following of this third law's view on the consequences (be them the direct ones) of such considering.

551 Third, the direct consequences foreseen by the third law might be irreconcilable with the rules of the *lex causae* regarding other questions of the relationship[495]. For instance, in criminal law, where the consequences are very strict, this might be very detrimental to the parties.

ee. Conclusion

552 There is no unambiguous answer to the question of which law should be applied to the direct consequences of the consideration of a third law's overriding mandatory rule. Here the following reasoning is applied in order to make the (difficult) choice. Even if one can accept that the act of considering (instead of applying) the third law's overriding mandatory rule entails empowerment of the adjudicator to define the law applicable to the consequences of such considering, this empowerment does not ensure the predictability that an explicit rule would ensure, which is why the latter is opted for here. Such a rule better confers competence to regulate to the law to which the overriding mandatory rule (being considered) belongs, since the concerned consequences – direct consequences – are too closely connected to this rule for one to subject them to a law other than the law of the latter.

b Law governing the indirect consequences

aa. No need of a rule due to adjudicator's discretion within «consideration»

494 VOSER, Lois d'application immédiate, 273 with regard to overriding mandatory rules of the state forum.

495 In this sense also VOSER, Lois d'application immediate, 273.

The theory discussed above (that the verb «to consider» delegates to the adjudicator the determination of the law governing the direct consequences of the consideration of a third law's overriding mandatory rule) would be valid also for an adjudicator's empowerment to determine the law applicable to the indirect consequences of such consideration because the argumentation was derived from the semantics of the verb «to consider», and not from the type of the concerned consequences. Hence, also here, the result of this logic is the lack of need of an explicit rule on the law to apply to the indirect consequences of the consideration of a third law's overriding mandatory rule. 553

bb. Law to be defined by the international arbitrator

As in the case of direct consequences, there is the possibility to install a rule that entrusts the international arbitrator with deciding which law should be applied to the indirect consequences. An analogical (to that above) sentence could be drafted: «The arbitrator applies to the indirect consequences of such consideration the law which they view as appropriate.». 554

cc. Law of the overriding mandatory rules

Even though with less intensity (because the indirect consequences of the consideration of an overriding mandatory rule are not as tightly connected to the latter as the direct consequences), the argument made above in respect of the direct consequences – that it is not good to split the consequences of a rule and such rule through submitting them to different laws – can be tried also here. 555

Then, the law of an overriding mandatory rule is certain to envisage suitable consequences for the consideration of this rule because it contains the latter whilst the *lex causae* is not – this *lex* might not even treat the matter addressed by the third overriding mandatory rule at all. 556

dd. *Lex causae*

Applying the *lex causae* to the indirect consequences of the consideration of overriding mandatory rules of a third law would be most natural because these consequences are not closely connected to such rules so that their distancing from the latter's law through their nearing to the *lex causae* is admissible. Also, 557

VOSER seems to deem the little closeness of indirect consequences to overriding mandatory rules as one of the heaviest arguments in favour of applicability of the *lex causae* to such consequences[496].

558 Then, since the indirect consequences concern the balance between the individual interests of the parties to the contract and the main task of the *lex causae* is to ensure this balance, it would be legitimate to apply the latter to such consequences[497].

559 Next, as it was for the direct consequences, the application of the *lex causae* to the indirect consequences of the consideration of overriding mandatory rules will conform with the exceptional nature of that consideration[498]. In fact, this argument has even greater strength in the case of indirect consequences – the latter are less connected to the third law's overriding mandatory rule, so it is even more certain that applying this rule's law to them would go beyond the narrow scope of exceptional giving of effect to a third law.

560 Further, potential contradictions between the consequences that the third law attaches to its overriding mandatory rule and the *lex causae*'s solutions regarding other matters of the relationship would be avoided.

561 Last but not least, the consideration of overriding mandatory law has an effect which is less intense than the application of it, which implies less bindingness of the adjudicator to it, including to the indirect consequences it envisages.

ee. Conclusion

562 Though also here there is no indisputable winner, the conflict between the laws seeking to govern the indirect consequences of the consideration of a third law's overriding mandatory rules is easier to resolve than the conflict between laws that want to regulate the direct consequences. As it was with the latter, it would not support legal certainty to leave the international arbitrator to decide.

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496 VOSER, Lois d'application immédiate, 278.

497 VOSER, Lois d'application immédiate, 278 (with regard to *lois d'application immédiate* in litigation).

498 VOSER, Lois d'application immédiate, 278 (with regard to *lois d'application immédiate* in litigation).

On the other hand, since the indirect consequences of the consideration of a third overriding mandatory rule are not so closely related to that rule, the need to apply the law of the latter is not so great as for the principal regulatory competence of the *lex causae* to be deviated from and, besides, the latter deals with the balance between the parties' individual interests, which is exactly what these indirect consequences concern. In other words, *lex causae* is here the «winner» of the competition.

3. Rule on competition between overriding mandatory rules

3.1 Draft

a If in Art. 187 (1) PILA the word «law» is not substituted with the expression «rules of law»

The following rule dealing with the competition between the overriding mandatory rules of different laws could be added as a new Art. 187 (4) PILA: 563

«Where rules of different laws want to apply mandatorily, each of these rules is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the law to which such a rule belongs. If such territorial limitation is not possible, the rule to be applied or considered is that which belongs to the law most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule cannot be determined among all these rules, to the extent possible, all these rules are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of a law other than the law which is designated by paragraph 1.»[499].

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[499] – in German perhaps: «*Wenn Bestimmungen verschiedener Rechte zwingend angewandt sein wollen, ist jede von ihnen auf diejenigen Tatbestände anzuwenden oder im Zusammenhang mit denjenigen Tatbeständen zu berücksichtigen, die im Hoheitsgebiet des Rechts, zu dem eine solche Bestimmung gehört, gelegen sind. Falls eine solche territoriale Beschränkung nicht möglich ist, ist diejenige Bestimmung anzuwenden oder zu berücksichtigen, die zu*

b If in Art. 187 (1) PILA the word «law» is substituted with the expression «rules of law»

564 In case the proposal for amending in Art. 187 PILA «law» to «rules of law» is adopted, the example of a new rule would read as follows:

«Where rules of law of different legal systems want to apply mandatorily, each of these rules of law is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the legal system to which such a rule of law belongs. If such territorial limitation is not possible, the rule of law to be applied or considered is that which belongs to the legal system most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule of law cannot be determined among all these rules of law, to the extent possible, all these rules of law are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of law of a legal system other than the legal system which is designated by paragraph 1.»[500].

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dem Recht, das den engsten Zusammenhang mit dem Sachverhalt aufweist, gehört, deren Zweck am schützenswertesten ist und deren Anwendung oder Berücksichtigung die nach universeller Rechtsauffassung angemessenste Entscheidung zur Folge hat. Falls eine solche Bestimmung unter allen diesen Bestimmungen nicht ausfindig gemacht werden kann, sind, soweit möglich, alle diese Bestimmungen anzuwenden und/oder zu berücksichtigen. Der dritte Satz des Absatzes 3 ist auf die Folgen der Berücksichtigung der Bestimmung eines anderen als des durch Absatz 1 bezeichneten Rechts anzuwenden.».

500 – in German something like: «*Wenn Rechtsnormen verschiedener Rechtssysteme zwingend angewandt sein wollen, ist jede von ihnen auf diejenigen Tatbestände anzuwenden oder im Zusammenhang mit denjenigen Tatbeständen zu berücksichtigen, die im Hoheitsgebiet des Rechtssystems, zu dem eine solche Rechtsnorm gehört, gelegen sind. Falls eine solche territoriale Beschränkung nicht möglich ist, ist diejenige Rechtsnorm anzuwenden oder zu berücksichtigen, die zu dem Rechtssystem, das den engsten Zusammenhang mit dem Sachverhalt aufweist, gehört, deren Zweck am schützenswertesten ist und deren Anwendung oder Berücksichtigung die nach universeller Rechtsauffassung angemessenste Entscheidung zur Folge hat. Falls eine solche Rechtsnorm unter allen diesen Rechtsnormen nicht ausfindig gemacht werden kann, sind, soweit möglich, alle diese Rechtsnormen*

3.2 Preservation of «capabilities» and case-by-case evaluation

The proposed rule is based on the idea that in a conflict with the overriding mandatory rule of another law, the respective overriding mandatory rule preserves its «capabilities» (e.g. the overriding mandatory rule of a third law keeps on being capable of being considered even if it contradicts an overriding mandatory rule *legis causae* which is to be applied (not only considered)), and its effect is defined according to the concrete situation. 565

3.3 The three solutions in the rule

SCHNYDER's rule of reason[501] is taken as a model for the rule proposed here. 566

The limitation of the legal effects of a competing overriding mandatory rule to the territory of the state which is its author, as proposed by SCHNYDER[502], is a good solution[503]. It conforms with the international public law's principle that the jurisdiction of each state is limited to the latter's territory. However, it is here considered that it is in fact not a solution to a problem of competition (but to a problem of something else) because in that case no competition exists – the effect of each overriding mandatory rule remains within the respective territory and the rules do not clash with each other. 567

Another suggestion of SCHNYDER – to look for the overriding mandatory rule which is worthiest of protection where it is impossible to separate the effects of the overriding mandatory rules territorially – is also adopted here. The draft rule sets concrete criteria which in effect represent namely criteria for defining which overriding mandatory rule is worthiest of being protected. The criteria 568

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anzuwenden und/oder zu berücksichtigen. Der dritte Satz des Absatzes 3 ist auf die Folgen der Berücksichtigung der Rechtsnorm eines anderen als des durch Absatz 1 bezeichneten Rechtssystems anzuwenden.».

501 See SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 322, 323.

502 SCHNYDER, Anwendung ausländischer Eingriffsnormen durch Schiedsgerichte, 322, 323.

503 – employed e.g. in *Morris Rothmans (WuW/E OLG 3051ff.)* where the court applied the competition law of the forum only to the facts of the case which evolved in the forum's territory (which allowed it to accommodate to a certain extent competing interests of a foreign law) – VOSER, Lois d'application immédiate, 279.

used are almost identical to the criteria used for the determination of whether an overriding mandatory rule of a third law deserves to be considered – only the legitimacy and manifest preponderance of a party's interests which such an overriding mandatory rule seeks to protect is omitted, but this is because anyway all competing overriding mandatory rules would fulfil this criterion, hence, the latter would not help in defining which overriding mandatory rule is to be applied or considered.

569 The last proposal of SCHNYDER – the cumulative connection – is also legitimate. Yet (as SCHNYDER also seems to mean) it is appropriate as a last resort. First, in some situations this connection might be impossible, since the rules in question might contain contradictory orders (hence, the phrase «to the extent possible» in the rule's draft here). Second, such a connection is quite burdensome for the parties, for many rules would be considered[504] – whilst it would sometimes result in the strictest rule imposing itself, as stated by SCHNYDER, that might not always be the case, and more (than one) rules might be applicable at once. Hence, the cumulative connecting of all competing overriding mandatory rules is here proposed as a method to be employed solely if the two previous approaches are not fruitful.

4. Summary

4.1 Summary of the drafts

a If in Art. 187 (1) PILA the word «law» is not substituted with the expression «rules of law»

aa. New rules

570 The following new sentence in Art. 187 (1) PILA:

[504] Though, on the other hand, the probability of need to comply with the (overriding mandatory) rules of various jurisdictions is inherent in the conclusion of international transactions, especially international financial transactions, which such parties voluntarily step into.

«The reference of this paragraph to a law encompasses all rules which, according to that law, apply to the facts of the case, including rules of a public law character.».

The following new Art. 187 (3) PILA: 571

«Instead of the law which is designated by paragraph 1, the rule of another law, which rule wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other law. Whether such a rule is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule are to be governed by this other law and the indirect consequences – by the law designated by paragraph 1.».

The following new Art. 187 (4) PILA: 572

«Where rules of different laws want to apply mandatorily, each of these rules is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the law to which such a rule belongs. If such territorial limitation is not possible, the rule to be applied or considered is that which belongs to the law most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule cannot be determined among all these rules, to the extent possible, all these rules are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of a law other than the law which is designated by paragraph 1.».

bb. How the whole Art. 187 PILA would look

(The text not formatted in italics is the current Art. 187 (1) PILA.) 573

«(1) The arbitral tribunal decides the disputed matter according to the law chosen by the parties or, in the absence of a choice of law, according to the law

with which the disputed matter is most closely connected. *The reference of this paragraph to a law encompasses all rules which, according to that law, apply to the facts of the case, including rules of a public law character.*

(2) The parties may authorise the arbitral tribunal to decide ex aequo et bono.

(3) Instead of the law which is designated by paragraph 1, the rule of another law, which rule wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other law. Whether such a rule is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule are to be governed by this other law and the indirect consequences – by the law designated by paragraph 1.

(4) Where rules of different laws want to apply mandatorily, each of these rules is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the law to which such a rule belongs. If such territorial limitation is not possible, the rule to be applied or considered is that which belongs to the law most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule cannot be determined among all these rules, to the extent possible, all these rules are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of a law other than the law which is designated by paragraph 1.».

b If in Art. 187 (1) PILA the word «law» is substituted with the expression «rules of law»

aa. New rules

574 The following new sentence in Art. 187 (1) PILA:

«The reference of this paragraph to rules of law encompasses all rules of law which belong to the respective legal system and which, according to the latter, apply to the facts of the case, including rules of law which have a public law character.».

The following new Art. 187 (3) PILA: 575

«Instead of the legal system which is designated by paragraph 1, the rule of law of another legal system, which rule of law wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other legal system. Whether such a rule of law is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule of law are to be governed by this other legal system and the indirect consequences – by the legal system designated by paragraph 1.».

The following new Art. 187 (4) PILA: 576

«Where rules of law of different legal systems want to apply mandatorily, each of these rules of law is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the legal system to which such a rule of law belongs. If such territorial limitation is not possible, the rule of law to be applied or considered is that which belongs to the legal system most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule of law cannot be determined among all these rules of law, to the extent possible, all these rules of law are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of law of a legal system other than the legal system which is designated by paragraph 1.».

bb. How the whole Art. 187 PILA would look

(The first sentence is one which has already been proposed within the current revision of PILA's Chapter 12) 577

«(1) *The arbitral tribunal decides the disputed matter according to the rules of law chosen by the parties or, in the absence of a choice of law, according to the rules of law with which the disputed matter is most closely connected. The reference of this paragraph to rules of law encompasses all rules of law which belong to the respective legal system and which, according to the latter, apply to the facts of the case, including rules of law which have a public law character.*

(2) The parties may authorise the arbitral tribunal to decide ex aequo et bono.

(3) Instead of the legal system which is designated by paragraph 1, the rule of law of another legal system, which rule of law wants to be applied mandatorily, may be considered when (according to a universal perception of law) legitimate and manifestly preponderant interests of a party so require and the facts of the case have a close connection with this other legal system. Whether such a rule of law is to be considered is decided having regard to its aim and the therefrom resulting consequences for an (according to a universal perception of law) appropriate decision. The direct consequences of the consideration of such a rule of law are to be governed by this other legal system and the indirect consequences – by the legal system designated by paragraph 1.

(4) Where rules of law of different legal systems want to apply mandatorily, each of these rules of law is to be applied or considered with regard to those of the facts of the case which are situated within the territory of the legal system to which such a rule of law belongs. If such territorial limitation is not possible, the rule of law to be applied or considered is that which belongs to the legal system most closely connected to the facts of the case, whose aim is the worthiest of protection and whose application or consideration would lead to (according to a universal perception of law) the most appropriate decision. If such a rule of law cannot be determined among all these rules of law, to the extent possible, all these rules of law are to be applied and/or considered. The third sentence of paragraph 3 applies to the consequences of the consideration of the rule of law of a legal system other than the legal system which is designated by paragraph 1.».

4.2 Summary of the applied connections

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The examples of rules proposed here cumulate a uniform connection for overriding mandatory rules *legis causae* with a special connection for overriding mandatory rules of a third law and treat overriding mandatory rules of the *lex fori* as a type of overriding mandatory rules of a third law.

Summary

Overriding mandatory rules are rules which, since they protect important public interests, need to be given effect (applied or at least considered) in an international private law case at any price, including where they do not make part of the *lex causae.*

579 These rules can be approached through the material law method (giving effect to their content by applying a concept of the *lex causae*) or the conflict of laws method (giving effect to them because of following a conflict of laws rule which orders such effect). Here, the conflict of laws method is deemed as more correct and is employed.

580 The conflict of laws rules of Chapter 12 PILA, which is devoted to international arbitration, are silent on the effect of overriding mandatory rules. By contrast, Chapter 1 PILA contains several conflict of laws rules (Art. 13, 18 and 19) which address the topic, but it is not known whether these apply to international arbitration, since it cannot be established whether PILA's rules outside its Chapter 12, like them, do so. Hence, there is a gap in the law.

581 This lack of express regulation is particularly cumbersome as overriding mandatory rules represent a big challenge for international arbitration, which is because they do not reconcile with some of the conceptual features of the latter, mostly the dominance of the parties' will.

582 Though some willingness to give effect to overriding mandatory rules is noticed, the current jurisprudence is rather inconsistent. Some international arbitrators apply or consider, some do not, and others avoid the topic by basing their award on some other concept.

583 *Analogia legis* is a way to handle the problem – but only temporarily until a permanent solution is found. In particular, Art. 13 and 19 of PILA's Chapter 1 might be applied by analogy; Art. 18 PILA cannot, since in international arbitration, overriding mandatory rules of the seat's law cannot be treated preferentially because that procedure was meant to be distant from this law, especially from this law's substantive part.

Analogia iuris is difficult to carry out. Albeit it is often felt that an international arbitrator needs to apply or consider overriding mandatory rules, due to the involvement of many opposing principles, this is not so certain as for one to be able to extract a principle capable of being applied in a concrete case. 584

The most appropriate solution is to adopt explicit conflict of laws rules in Chapter 12 PILA which deal with overriding mandatory rules. The new rules could construct a uniform connection for the overriding mandatory rules of the *lex causae.* For the overriding mandatory rules of a third law, they could foresee a special connection. The overriding mandatory rules of the *lex fori* they would have to treat as overriding mandatory rules of a third law, hence not preferentially, for international arbitration is independent of the seat's substantive law. Last but not least, with regard to the case of competition between overriding mandatory rules of different laws, they could order that: each of the concerned rules is applied or considered in relation to those of the facts which evolved within the territory in which the law of such a rule is in force; that where such fragmentation is impossible, the rule which mostly lives up to certain conditions (the conditions for consideration of a third law's overriding mandatory rule) is applied or considered; and that where such a rule cannot be nominated, as far as possible, all rules are applied and/or considered. When drafting the new rules, those of the conflict of laws rules of Chapter 1 PILA which deal with the same type of overriding mandatory rules (which would be Art. 13 and 19 PILA) could be overtaken and, where necessary, adapted to the specificities of international arbitration, thus ensuring at the same time coherence with the rest of PILA and regard to the needs of international arbitration. In any case, more important than their content is that the rules are adopted in the first place, as this would bring the minimum legal certainty longed for. 585

Curriculum Vitae

Hristina Tsankova Marjanović, born on 2 July 1988, obtained her master law degree from University of Sofia "St. Kliment Ohridski", Bulgaria, in 2013. In 2010, she attended a summer law school organised by the European Law Students' Association (ELSA) in Istanbul, Turkey, on mergers and acquisitions. In the academic year of 2010-2011, she spent two exchange semesters at Ghent University, Belgium, where she attended diverse courses focusing mainly on banking and capital markets and EU law. In the last year of her master studies, she participated at Central & Eastern European Moot Court Competition, Malta, conducted under the auspices of the Court of Justice of the EU and the University of Cambridge.

In 2014, she obtained an LL.M. degree with distinction *magna cum laude* in International Banking and Finance Law from the University of Zurich, Switzerland. Her LL.M. thesis was titled Swiss International Arbitration – Exercise of Rights Conferred by Competition Law upon Private Persons.

In 2014, she started her PhD studies at the Law Faculty of the University of Zurich under the supervision of Prof. Dr. Anton K. Schnyder. Her doctorate was chosen to be partially funded by a fund of the University of Zurich for selected dissertation projects – Forschungskredit "Candoc" – as well as by a general fund of the University of Geneva – Fonds Katzarovi. During her doctoral studies, she attended the annual conference of the Panel of Recognized International Markets Experts in Finance (P.R.I.M.E Finance), the Hague, Netherlands, and colloquia in Germany, Austria and Slovenia where she presented and discussed interim results of her research.

During her master and LL.M. studies she completed traineeships at UniCredit Leasing, S.p.A., Vienna, Austria (2012) and Schellenberg Wittmer, Attorneys at law, Zurich, Switzerland (2013). At the time of her doctorate – in 2014 – she worked as a research assistant at the corporate legal department of the headquarters of Zurich Insurance Group, Zurich, Switzerland (within a cooperation project with Europe Institute Zurich, Switzerland). She was also legal counsel at GenTwo Ltd., Financial Products, Zurich, Switzerland – in 2018 and 2019. Since 2020 she is part of the legal team of Ernst & Young Ltd., Zurich, Switzerland.